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1 UNITED STATES DISTRICT COURT  
2 SOUTHERN DISTRICT OF NEW YORK

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3 UNITED STATES OF AMERICA,

New York, N.Y.

4 v.

18 Cr. 0036(JPO)

5 DAVID MIDDENDORF and JEFFREY  
6 WADA,

7 Defendants.

8 -----x

9 February 12, 2019  
10 9:40 a.m.

11 Before:

12 HON. J. PAUL OETKEN,

13 District Judge  
14 and a jury

15 APPEARANCES

16 GEOFFREY S. BERMAN

United States Attorney for the  
Southern District of New York

17 BY: REBECCA G. MERMELSTEIN

18 AMANDA K. KRAMER

JORDAN LANCASTER ESTES

19 Assistant United States Attorneys

20 PETRILLO KLEIN & BOXER LLP

Attorneys for Defendant David Middendorf

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- and -

23 BRUCH HANNA LLP

24 BY: GREGORY S. BRUCH

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APPEARANCES CONTINUED

BROWN RUDNICK LLP

Attorneys for Defendant Jeffrey Wada

BY: STEPHEN COOK

JUSTIN S. WEDDLE

SELBIE JASON

- and -

LATHAM & WATKINS

BY: JASON MASASHI OHTA

- also present -

Lyeson Daniel, Postal Inspector

Virginia Faughnan, Postal Inspector

Luke Urbanczyk, Government Paralegal

Nathaniel Cooney, Government Paralegal

Kiezia Girard-Lawrence, Postal Inspector

Stephanie O'Connor, Defendant Middendorf paralegal

Sarah Chojecki, Defendant Wada paralegal

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(Trial resumed; jury not present)

THE COURT: Good morning, everyone.

Unfortunately, we are still missing one juror. Two of the jurors were about 10 minutes late and we are waiting for the final juror. Mr. Hampton had taken all their cell phones so he just tried calling and she answered and she's in a taxi. She said she woke up late and -- it is juror no. 36 -- I'm sorry, not 36 -- well, she was 36 but 16, juror no. 16, Ms. King. She said she is in a cab 25 minutes away a minute ago. So, we can either wait, or not.

MS. MERMELSTEIN: May we have a moment to confer, your Honor?

THE COURT: Sure.

(Counsel conferring)

MS. KRAMER: Your Honor, we understand that defense counsel wants to wait for the juror to arrive so we have no objection to that.

THE COURT: Okay.

MR. COOK: Yes, your Honor. We were here late, it is the first day.

THE COURT: Yes.

MR. COOK: We should give her the benefit of the doubt.

THE COURT: And you agree?

MR. BOXER: We do.

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1 THE COURT: I think that makes sense. I mean, I would  
2 hate to give the other jurors the thought that they could do  
3 the same thing. So, we will keep you posted. I think it might  
4 be -- well, it will probably be 20 minutes or so. So, does  
5 anybody have anything they wanted to address in advance of  
6 openings?

7 MR. BOXER: No, your Honor.

8 MR. COOK: No, your Honor.

9 MS. ESTES: Your Honor, just one thing.

10 As your Honor knows, there was motion practice over  
11 the weekend about whether the exhibit of the list on  
12 Middendorf's phone, the notes function, is admissible. I think  
13 the parties agree that because Middendorf admitted that he kept  
14 a list on the notes function that at least something about that  
15 is going to come into evidence. So, we are going to open on  
16 that. We are not going to open on when the list was created or  
17 anything like that, just that in 2017 he wrote down the list on  
18 a notes function.

19 THE COURT: You expect that to come in through  
20 testimony of a witness, that fact?

21 MS. ESTES: Yes, your Honor.

22 THE COURT: Okay. That's fine.

23 All right. We will be in recess for about 20 minutes  
24 and we will let you know. If you can stick around we will let  
25 you know when the final juror arrives.

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1 (recess)

2 THE COURT: All the jurors are here now. I understand  
3 that there is an issue that the parties wanted to address but  
4 if it can wait, we can bring in the jurors and start.

5 MR. COOK: It was our issue, your Honor, and we can  
6 wait.

7 THE COURT: Okay. All right. Ready for the jury?

8 MS. KRAMER: Yes, your Honor.

9 THE DEPUTY CLERK: All rise. Jury present.

10 (Continued on next page)

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(Jury present)

THE COURT: Please, be seated.

Good morning, ladies and gentlemen.

THE JURY: Good morning.

THE COURT: Ladies and gentlemen, now you have been worn in as jurors in this case. I want to tell you briefly about your duties as jurors and give you some instructions. After the trial after all of the evidence, I will give you detailed instructions and those instructions will control your deliberations.

At the end of the presentation of the evidence and my final charge to you, it will be your duty to decide from the evidence what the facts are and then apply the law to those facts. In doing so, you must follow the law as I give it to you. Remember, you are the sole judges of the facts.

You must not take anything I may say or do during the trial as indicating what your verdict should be. Do not be influenced by my taking notes or typing something on my laptop. What I write down may have nothing to do with this case or this trial and you should not be concerned with it.

You, the jury, and I the Court, play different roles in this proceeding. My main duties are to rule on objections, oversee the trial, and at the end of the trial, to instruct you on the law that applies. Your duty is to accept those instructions of law and to apply them to the facts as you find

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1 them.

2 So, as members of the jury, you are the sole and  
3 exclusive judges of the facts. You pass on the evidence. You  
4 determine the credibility of the witnesses. You resolve any  
5 conflicts that there may be in the testimony. You draw  
6 whatever reasonable inferences that you decide to draw from the  
7 facts as you find them, and you determine the weight of the  
8 evidence.

9 To that end, do not conclude from any of my questions  
10 or any of my rulings on objections or anything else that I say  
11 or do during the trial that I have any view on the credibility  
12 of witnesses, or how you should decide the case. Any opinion I  
13 might have regarding the facts is of no consequence. It is  
14 your duty, your sworn duty, and you have taken the oath, as  
15 jurors, to determine the facts.

16 Now, just as I have my duties as a judge and you have  
17 your duties as jurors, it will be the duty of each lawyer in  
18 the case to object when the other side offers testimony or  
19 other evidence that the attorney believes is not properly  
20 admissible. It will be my job to rule on those objections.  
21 Therefore, why an objection was made or how I rule on it is not  
22 your business, not your concern. You should draw no inference  
23 from the bare fact that an attorney objects to any evidence,  
24 nor should you draw any inference from the fact that I might  
25 sustain an objection or overrule an objection.

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1           From time to time, the lawyers and I may hold  
2 conferences at side bar out of your hearing. Those conferences  
3 involve procedural and other legal matters and none of the  
4 events relating to those conferences should enter continue your  
5 deliberations.

6           To be clear, the personality and conduct of counsel in  
7 the courtroom are not at issue. If you form any reactions of  
8 any kind to any of the lawyers in the case, favorable or  
9 unfavorable, whether you approve or disapprove of their  
10 behavior as advocates, those reactions should not be part of  
11 your deliberations.

12           Now, I have referred to the term "evidence" in this  
13 case and that raises an important question that I want to  
14 explain: What is evidence?

15           Evidence consists of the sworn testimony of the  
16 witnesses, the exhibits that are received in evidence, and the  
17 stipulations of the parties, that is, agreements of the parties  
18 about certain facts. In determining the facts you must rely on  
19 your own recollection of the evidence.

20           So, what is not evidence? The following does not  
21 count as evidence:

22           First, any testimony that I strike or exclude. If I  
23 say "that is stricken," that is not evidence and I will direct  
24 you not to consider it as evidence.

25           Second, any exhibit that was not received in evidence.



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1 Third, arguments by lawyers are not evidence and the  
2 reason is simple. Advocates -- lawyers -- are not witnesses.  
3 The opening and closing arguments of each party explain how  
4 they want you to analyze and think about the evidence which  
5 consists of the testimony of witnesses and the documents and  
6 exhibits that are entered into evidence. What the lawyers will  
7 say is intended to help you understand the evidence or the lack  
8 of evidence when you deliberate to reach your verdict. But,  
9 only the witness' answers are to be considered evidence, not  
10 the attorneys' questions.

11 Finally, any statement that I may make does not count  
12 as evidence.

13 You will have an opportunity to observe the witnesses.  
14 It will be your job to decide how believable or credible each  
15 witness was in his or her testimony. You are the sole judges  
16 of the credibility of each witness and the importance of his or  
17 her testimony. It is for you, the jury, and you alone, not the  
18 lawyers, not the witnesses, and not me as the Judge, to decide  
19 the credibility of witnesses who testify and the weight that  
20 their testimony deserves.

21 The ultimate question for you to decide in passing on  
22 credibility is did the witness tell the truth before you in  
23 this courtroom?

24 Now, this is a criminal case. That means that the law  
25 presumes each defendant to be innocent of all charges. The

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1 government has the burden of proving each defendant's guilt  
2 beyond a reasonable doubt. The burden does not shift to the  
3 defendants. In other words, the defendants do not have to  
4 prove their innocence. They are presumed to be innocent of the  
5 charges in the indictment. Each defendant, therefore, begins  
6 the trial with a clean slate. This presumption of innocence  
7 alone is sufficient to acquit each defendant unless you, as  
8 jurors, are unanimously convinced beyond a reasonable doubt, of  
9 that defendant's guilt after a careful and impartial  
10 consideration of all of the evidence in the case. It is  
11 removed, if and only if you, as members of the jury, are  
12 satisfied that the government has sustained its burden of  
13 proving each particular defendant's guilt beyond a reasonable  
14 doubt.

15 I also want to caution you about certain principles  
16 governing your conduct as jurors. First, and I highlighted  
17 some of these last night before you went home. First, you may  
18 not talk to each other about the case or about anyone having to  
19 do with the case until the end of the case when I send the jury  
20 to the jury room to deliberate. I will instruct you at that  
21 time that you are then free to begin deliberating as a jury.  
22 That's very important. As the case is going on you are not to  
23 talk about, oh, what I thought about that witness or that piece  
24 of evidence. It is only when all of the evidence is done that  
25 the jury can deliberate. You are welcome to talk to each other

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1 about your kids and the weather and whatever else you want but  
2 not about this case or about the evidence as it is coming in.

3 Second, you may not talk with anyone else about this  
4 case or with anyone who has anything to do with it, again,  
5 until the trial has ended and you have been discharged as  
6 jurors. Anyone else includes members of your family and your  
7 friends. You may tell them that you are a juror in a criminal  
8 case, but please do not tell them anything else about it until  
9 after you have been discharged by me at the end of the trial.

10 Third, do not talk with anyone about the case, do not  
11 let anyone talk to you about the case or about anyone having  
12 anything to do with it. If someone tries to speak to you about  
13 the case during the trial, please, report it to me immediately  
14 through Mr. Hampton or a court security officer. This includes  
15 lawyers and witnesses in the case.

16 So, if you happen to run into one of the lawyers or  
17 witnesses in the hallway or in the elevator, please, do not  
18 speak to them. If they don't speak to you it doesn't mean  
19 they're being rude, it is because I have told them not to speak  
20 with anyone on the jury while the trial is going on.

21 Fourth, you may not do any research or investigation  
22 about the case on your own. Do not read any news stories or  
23 articles about the case or anyone having to do with it. You  
24 may not use Google or the Internet or any other source to  
25 research an aspect about the case or any of the people

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1 involved.

2 Also, do not go to visit any of the scenes that might  
3 come up during the trial. And this is important. This is  
4 because the case must be decided based on the evidence admitted  
5 in this trial. The parties have a right to that and it is your  
6 duty to follow that instruction.

7 Also, please do not use any social media to discuss  
8 the case or any of the people involved. That means no Facebook  
9 or Twitter or SnapChat or any social media sites having to do  
10 with the case; or blogging about the case at all during the  
11 trial.

12 The parties are entitled to have you personally render  
13 a verdict on the case, in the case, based on your independent  
14 evaluation of the evidence presented here in this courtroom in  
15 this trial. Speaking to others about the case, including your  
16 family before you deliberate, or exposing yourself to things  
17 outside the courtroom relating to the case, would compromise  
18 your service and the fairness to the parties.

19 Finally, I am going to outline briefly the summary of  
20 the stages of the trial for you.

21 In a few minutes each party will be able to make an  
22 opening statement, though they are not required to. An opening  
23 statement is not evidence. It is an outline by that party, by  
24 their lawyer, intends to prove and it helps you follow the  
25 evidence.

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Opening - Ms. Estes

1           Next, the government will present witnesses and the  
2 defendants may cross-examine the witnesses. The defendants are  
3 not required to present any witnesses or evidence but they may,  
4 if they wish.

5           After that, the attorneys will make their closing  
6 arguments or summations to summarize or give you their  
7 interpretation of the evidence. As with opening statements,  
8 the closing arguments are not evidence. After the closing  
9 arguments, I will give you instructions on the law and then you  
10 will retire to deliberate on your verdict in the jury room.

11           Please do not make up your mind about what the verdict  
12 should be until I have instructed you on the law at the end of  
13 a case. Keep an open mind until then and you have gone to the  
14 jury room and you and your fellow jurors have had a chance to  
15 discuss the evidence. Keep an open mind.

16           The parties deserve and the law requires that you give  
17 them an opportunity to be fully heard. That concludes my  
18 preliminary instructions and we are now prepared to have  
19 opening statements by counsel for the parties. We will begin  
20 with the government.

21           Ms. Estes?

22           MS. ESTES: Yes, your Honor.

23           Good morning. This is a case about cheating and  
24 corruption. It is about high-level executives at KPMG, a major  
25 accounting firm, conspired to steal secret information. Now,

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Opening - Ms. Estes

1 why did they do it? So they could cheat. The KPMG executives  
2 used that stolen information to cheat on inspections into the  
3 quality of KPMG's work. And these inspections were kind of  
4 like tests, tests that were very important to KPMG. Now, KPMG  
5 had been failing these tests so something had to change but  
6 instead of playing by the rules, they decided to game the  
7 system. Now, how did they do it? By stealing and using  
8 confidential information from the regulator who conducts the  
9 inspections into KPMG's work. The regulator is the Public  
10 Company Accounting Oversight Board also known as the PCAOB. I  
11 will refer to it as the Oversight Board.

12 How did they get access to the information from the  
13 Oversight Board? From corrupt insiders at the Board who were  
14 willing to betray their duty of trust and confidentiality and  
15 leak the information to KPMG.

16 This man, David Middendorf, he was one of the KPMG  
17 executives who carried out the cheating scheme. He oversaw the  
18 inspections group at KPMG so he was responsible for making sure  
19 they were doing well on inspections and when they were doing  
20 poorly, he was the one who had to turn things around.

21 This man, Jeffrey Wada, he was one of the corrupt  
22 insiders at the Oversight Board. Throughout the scheme he  
23 worked at the Board, he stole confidential information, and he  
24 passed it on to his criminal associates at KPMG.

25 So, Middendorf and Wada, they were two links in a

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1 chain of corruption and that's why we are here today, because  
2 these two men engaged in a criminal conspiracy to steal  
3 confidential information from the Oversight Board. It was  
4 cheating, plain and simple, and we are here to hold them  
5 accountable for their crimes.

6 So, what will the evidence show? Now, before I get  
7 into the cheating scheme I want to talk about some important  
8 background information you will learn during the trial. You  
9 will learn all about accounting firms like KPMG, how they do  
10 their work and how they're regulated.

11 You will learn that KPMG is one of the nation's four  
12 largest accounting firms and one of the biggest pieces of its  
13 business is auditing public companies which are just companies  
14 whose shares trade on the stock exchange, companies like Apple  
15 or Coca-Cola.

16 Now, each year public companies have to file financial  
17 statements publicly with the United States Securities and  
18 Exchange Commission, an important government agency. Now, why  
19 do they have to do that? So that the investing public can look  
20 at the financial statements in deciding whether they want to  
21 buy shares of stock in a company.

22 So, these financial statements, they give an important  
23 picture of a public company's financial health. Is it  
24 profitable? What are its assets? What are its debts? Should  
25 I buy or should I sell?

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1           Now, because these financial statements are so  
2 important, you can't just assume everything a company says in  
3 them is correct. So, during this trial you will learn that the  
4 law requires that independent auditors go through the financial  
5 statements, they examine them, they test them, and they  
6 ultimately sign off on their accuracy. They act as a watchdog.

7           Now, when the auditors go through the financial  
8 statements, when they run through all the numbers, that's what  
9 an audit is. And then they certify that the statements are  
10 accurate. And that's important so that the public can rely on  
11 those financial statements in deciding whether they want to buy  
12 or sell shares of stock in a company. So, the auditors, they  
13 go through the financial statements but somebody has to make  
14 sure the auditors are doing a good job and that's where the  
15 Oversight Board -- the PCAOB -- comes in.

16           Now, you will learn that after a wave of accounting  
17 scandals, Congress created the Oversight Board to make sure  
18 auditors were doing a good job. They, essentially, audit the  
19 auditors. They watch the watchmen. So, as part of its  
20 mission, each year the Oversight Board inspects each of the big  
21 accounting firms like KPMG and, as part of that process, they  
22 inspect individual audits that the firm performs.

23           So, as an example, if KPMG audited the financial  
24 statements of IBM and the Oversight Board wanted to inspect  
25 that audit, after the audit was complete and after all of the



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1 documentation was complete, the Oversight Board would go to  
2 KPMG, they would ask to see the work on the audit, and they  
3 would go through it to make sure that KPMG did a thorough and  
4 high quality audit, to make sure the auditors used good  
5 judgment and acted with integrity.

6 Now, you will learn that firms like KPMG audit the  
7 financial statements of hundreds of companies a year so  
8 naturally the Oversight Board can't go through each and every  
9 one. Instead, they pick a sample of audits each year to  
10 inspect and for a firm like KPMG it is about 50. After the  
11 Oversight Board does inspections, they give grades to the firms  
12 like KPMG. Now, the list of that sample of audits they're  
13 going to inspect, that is a valuable and important secret.  
14 Because the Oversight Board only looks at a sample of audits  
15 they don't tell the firms until just before the inspections  
16 which audits they're going to inspect because if they did that,  
17 the firms would just put more resources on those audits, they  
18 would put more people on those audits, they would devote more  
19 time to those audits and then the Oversight Board wouldn't get  
20 a true view into overall audit quality at the firm.

21 So, think of it like a restaurant inspection by the  
22 health department. The element of surprise is important so  
23 that the health inspectors get a true view of a restaurant's  
24 food safety practices -- how clean the restaurant is, how fresh  
25 the food is. If a dirty restaurant knew when the health

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1 department was coming, it would just make sure it was perfectly  
2 clean that day, just like that; the bathroom would be spotless.

3 So, think about it. You feel comfortable eating at a  
4 restaurant with an A rating because you know it is clean on any  
5 given day, not just on the day when it hurried to clean up  
6 because it had inside information that health inspectors were  
7 coming.

8 Now likewise, the Oversight Board doesn't tell the  
9 firms which audits they are going to inspect until just before  
10 the inspections so they administer these inspections kind of  
11 like pop quizzes. Only after the audit is over and after all  
12 the audit documentation is complete do they tell the firm what  
13 audits they are going to inspect. That way the firm can't make  
14 any changes to the audit procedures or to the work papers and  
15 the Oversight Board gets a true view into overall audit quality  
16 of the firm.

17 Now, after the oversight board does the inspections,  
18 you will learn they issue a report detailing their findings and  
19 that's where the United States Securities and Exchange  
20 Commission -- the SEC -- comes in.

21 Now, you will learn the SEC is an important government  
22 agency and it is responsible for making sure the public has  
23 access to reliable financial information on publicly traded  
24 companies. Now, because auditors are those watch dogs that go  
25 through the financial statements, the SEC also has the ability

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1 to monitor auditors. So, you will learn they can implement  
2 rules and regulations to make sure audit quality is top notch.  
3 They also have the ability to institute enforcement actions and  
4 to level fines and penalties against auditors that aren't doing  
5 a good job.

6 Now, those inspection reports from the Oversight  
7 Board, you will learn that each of those reports goes to the  
8 SEC and the SEC relies on those reports to do its job of  
9 regulating auditors and protecting the public.

10 Now, with that background, I am going to return to the  
11 cheating scheme.

12 You will learn that in the years leading up to the  
13 scheme, KPMG was doing poorly on Oversight Board inspections.  
14 The Board had found deficiency after deficiency in the quality  
15 of KPMG's audits, particularly in certain audits involving  
16 banks. So, Middendorf and the other executives, they were  
17 desperate to improve. So, what did they do? Well, they did  
18 try to do better audit work. They did. But they didn't stop  
19 there. They wanted an edge, a secret edge, an end run around  
20 the regulatory system that Congress put in place in the wake of  
21 past accounting scandals and in looking for that edge they  
22 crossed a line, a criminal line. They engaged in a scheme to  
23 steal confidential information and to use it to cheat.

24 So, how did the scheme begin? Well, you will learn  
25 that in 2015, Middendorf and other executives at KPMG began

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1 recruiting individuals from the Oversight Board to come work at  
2 KPMG. Now, one of those individuals were a man named Brian  
3 Sweet. When Sweet was at the oversight board he worked on KPMG  
4 inspections so they thought he could help turn inspection  
5 results around.

6 Now, you will learn that before he left the Oversight  
7 Board he took that secret inspection list, the list of  
8 inspection targets, and he saved it to a personal hard drive.  
9 He then walked out the door with it. Now, when he got to KPMG,  
10 Middendorf and the other executives started pumping him for  
11 confidential inside board information so he gave them the  
12 secret inspection list. Now, at that point the audits were  
13 over but the inspections had not been publicly announced so  
14 they had more time to prepare for the inspections, they knew  
15 the pop quiz was coming. And, the information Sweet provided  
16 even told them what the Oversight Board would focus on during  
17 the inspections.

18 So, they had their first taste of that illegal edge.  
19 Middendorf was happy and they wanted Sweet to keep the  
20 information flowing.

21 Now, in 2016 it was even more important that they get  
22 that information. You will learn that that year members of the  
23 SEC confronted KPMG leadership, including David Middendorf at a  
24 meeting, about inspection results. They said inspection  
25 results had to get better, things had to change. So, the

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1 pressure was on. Now, that year the information was leaked by  
2 Jeffrey Wada. You will learn he was the one who leaked it and  
3 he leaked it to Sweet's associate. So, why did he do it? He  
4 was disgruntled. He was unhappy that he had not been promoted  
5 at the Oversight Board and he was hoping to eventually come  
6 work at KPMG just like Brian Sweet. So, he betrayed his duty  
7 of trust and confidentiality to the Oversight Board because the  
8 information he supplied, it wasn't his to take. So, that year  
9 he was the first link in the chain of corruption. He gave it  
10 to Sweet's associate who passed it on to Sweet, and Sweet  
11 passed it on to his bosses David Middendorf, and a man named  
12 Thomas Whittle, who was head of inspections at KPMG. Once  
13 again, they ate it up.

14 This year they had gotten the lists even earlier so  
15 there were even more things they could do to exploit it. You  
16 will learn that when they got the list the audits were complete  
17 but the audits were in a brief window after the completion of  
18 the audits where they had time to document and explain their  
19 work. Now, that documentation is called the audit file or the  
20 work papers. It's the core work the Oversight Board  
21 scrutinizes during these inspections. It matters a lot.

22 So, Middendorf, Sweet, and the others, they came up  
23 with a criminal plan, a way to use that inspection list  
24 secretly. They came up with an illicit program to take a  
25 second pass at the audit documentation to improve it, to make

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1 it better, all so they would do better on those Oversight Board  
2 inspections. And they didn't want anybody else at KPMG to know  
3 about it because if other people found out, it could blow up  
4 the whole cheating scheme so they disguised this review by  
5 making it seem like it was part of a program already in place  
6 at the firm. It was a stealth review made to seem legitimate  
7 to outsiders.

8 So Sweet and all the others, they went into the  
9 documentation and they made as many changes as they could  
10 without getting caught. And that year, the cheating worked.  
11 You will learn that KPMG did vastly better on certain parts of  
12 the inspections than it had in years past.

13 So, what happened in 2017? You will learn Wada leaked  
14 the information again, again to Sweet's associate. That year  
15 he called the secret inspection targets his "grocery list."  
16 That was his code name he used. He was, again, the first link  
17 in the chain that year and it was, again, passed all the way up  
18 to Middendorf, and you will learn Middendorf was closely  
19 tracking that information. He wrote it down in the notes  
20 function of his cell phone.

21 But that year Brian Sweet, he made a mistake. He  
22 didn't just share the information with his co-conspirators, he  
23 also told a KPMG employee whose audit was on the list to be  
24 inspected. She knew she wasn't supposed to have the  
25 information, she knew it was wrong, so she reported it to her

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1 boss and then the scheme began to unravel. You will learn that  
2 KPMG ultimately came clean to the Oversight Board and to the  
3 SEC and it was over, they had all gotten caught.

4 Now, for their involvement in the scheme, the  
5 defendants have been charged with serious crimes. They have  
6 been charged with conspiring to defraud the Oversight Board and  
7 actually committing that fraud, basically stealing confidential  
8 information. And they've been charged with conspiring to  
9 defraud the SEC by interfering with functions it performs in  
10 order to protect, in order to fulfill its mission of protecting  
11 the investing public. You see, as part of making sure that the  
12 public has access to reliable financial information on publicly  
13 traded companies they regulate auditors, the watchdogs, to make  
14 sure they're doing a good job, and they rely on those  
15 inspection reports to do that.

16 Now, the defendant's scheme, it was designed to  
17 falsely inflate audit quality in the inspection reports making  
18 them unreliable to the SEC and you will learn that interfered  
19 with its job to regulate auditors and protect the public.

20 Now, how are we going to prove this to you? First you  
21 are going to see and hear the defendants' own words. You will  
22 see e-mails and text messages. You will hear voice mails where  
23 Jeffrey Wada lists the inspection targets where he called it  
24 his grocery list. You will see a text message with the same  
25 language. You will see e-mails where Middendorf and others

J2C5mid1

Opening - Ms. Estes

1 received the 2015 inspection list. You will see discussions  
2 about how sensitive the information is, how they need to be  
3 discreet about it. And those e-mails, they will make clear  
4 that there was nothing legitimate about what they were doing.  
5 They knew the list was secret, they knew they were not supposed  
6 to have it, and they knew they were not allowed to use it.

7 Now, you will also see call records showing this  
8 corrupt scheme in action.

9 (Continued on next page)

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J2CYMIDT2

Opening - Ms. Estes

1 MS. ESTES: You will see the calls where the  
2 information was shared and where they schemed about how to use  
3 it. You'll see the calls from Wada to Sweet's associate.  
4 You'll see the calls from Sweet to Whittle and Middendorf.

5 And you'll also see those lists, the secret, highly  
6 confidential lists. You will see the list Middendorf received  
7 in 2015. You will hear about the list he received in 2017, and  
8 you will see a copy of the list that Brian Sweet had in 2017  
9 that he ultimately burned in his barbecue.

10 Now, that's right. When the scheme started to  
11 unravel, he didn't just hide the list. He didn't throw it  
12 away. He burned it in his barbecue to cover up the crime.

13 Now you're also going to hear from witnesses. You  
14 will hear from a witness from the oversight board. She will  
15 tell you how valuable the inspection list is and how critical  
16 it is that the auditing firms don't know ahead of time which  
17 audits are going to be inspected.

18 You'll hear from a witness from the SEC. He will tell  
19 you how the SEC relies on the reports to do its job of  
20 regulating auditors and protecting the public.

21 You'll hear from the whistleblowers, the ones at KPMG  
22 who reported the illicit scheme. And you will hear from two  
23 members of the criminal scheme, Brian Sweet and Tom Whittle.

24 Now, they will take you inside the conspiracy as only  
25 an insider can. They will tell you how it works, how they hid

J2CYMIDT2

Opening - Ms. Estes

1 it from others. They know all the details because they were  
2 part of it.

3 Now, Brian Sweet was the one who worked at the  
4 oversight board and then came to work at KPMG. He'll tell you  
5 how he took the list in 2015, he'll tell you how Middendorf  
6 pumped him for confidential information, and he'll tell you how  
7 Jeffrey Wada was the one who leaked the list in 2016 and 2017.

8 Now, Tom Whittle -- he was the head of inspections at  
9 KPMG. He'll tell you how he, Middendorf, and Sweet put more  
10 resources in the audits they knew were on the list because they  
11 knew those would be inspected.

12 Now, ladies and gentlemen, make no mistake. Tom  
13 Whittle and Brian Sweet committed serious crimes. They've  
14 accepted responsibility and pled guilty. Now, you'll learn  
15 they're not testifying out of the goodness of their hearts but  
16 in the hopes of receiving a reduced sentence.

17 So when you consider their testimony, look at it  
18 closely and carefully. Ask yourself whether it makes sense and  
19 whether it's backed up by the other evidence -- the emails, the  
20 text messages, the voicemails, the call records.

21 Now, at the end of this trial, you will have seen  
22 overwhelming evidence of the defendants' guilt. But between  
23 now and then, I'd like to ask you to do three things: First,  
24 pay close attention to the evidence; second, follow  
25 Judge Oetken's instructions on the law; and third, use your

J2CYMIDT2

Opening - Mr. Boxer

1 common sense, the same common sense you've used in your  
2 everyday lives as New Yorkers.

3 If you do those three things, the defendants will get  
4 a fair trial, the government will get a fair trial, and we are  
5 confident you will return the only verdict consistent with the  
6 evidence, that the defendants are guilty as charged.

7 THE COURT: Thank you.

8 We'll now have the opening statement on behalf of  
9 Mr. Middendorf.

10 Mr. Boxer.

11 MR. BOXER: Thank you, your Honor.

12 THE COURT: You can pull the mike closer if you'd  
13 like.

14 MR. BOXER: May it please the Court, counsel, members  
15 of the jury.

16 Mr. Middendorf worked for 30 years at KPMG, his entire  
17 professional career. Most of that time he worked in the field  
18 in Dallas, in Cincinnati, in Atlanta. And he was eventually in  
19 charge of audits for some of KPMG's most prestigious clients --  
20 JC Penney, Macy's and Home Depot.

21 He was an auditor well-respected by his clients and by  
22 his colleagues. He even served on KPMG's board of directors  
23 for five years. And in 2014, he was promoted to be the  
24 national managing partner for New York of audit quality and  
25 professional practice.

J2CYMIDT2

Opening - Mr. Boxer

1           After that, he commuted to New York from his home in  
2 Atlanta where he lives with his wife and his three teenaged  
3 daughters. As the national managing partner, he helped put in  
4 place many initiatives at KPMG to improve audit quality with  
5 technical terms like accelerating audit execution, heightened  
6 root cause analysis, and pre-inspection reviews. In short,  
7 Mr. Middendorf spent his entire career committed to the  
8 profession of public accounting and to KPMG.

9           So how did he end up here. Not because Mr. Middendorf  
10 received any money or any financial benefit, not because he  
11 backdated or falsified any audit work papers, not because he  
12 did something because he was worried that KPMG might lose a  
13 client, and not because he traded on any inside information in  
14 the securities market or anything like that.

15           We're here because the government alleges that what  
16 you may think was poor judgment or a bad decision or a mistake  
17 was a federal crime. Cheating is not a federal crime.  
18 Mr. Middendorf did not have an intent to commit the crime  
19 charged here which is fraud, period. And because of that, the  
20 government will not be able to prove Mr. Middendorf's guilt  
21 beyond a reasonable doubt.

22           As you heard, the government's case focuses on three  
23 events: First, in May 2015, Mr. Middendorf received by email a  
24 list of KPMG audits that the PCAOB was going to inspect later  
25 that year. He did not respond to the email, he did not forward

J2CYMIDT2

Opening - Mr. Boxer

1 the email, and he did not do anything with respect to the list  
2 attached to the email.

3 Second, in March 2016, Mr. Middendorf authorized  
4 assigning additional people to review the work papers of 11  
5 audits that Mr. Sweet said the PCAOB was going to inspect later  
6 that year or would likely inspect.

7 Why did he permit that? Why did Mr. Middendorf do  
8 that? Because he didn't see any harm to the PCAOB or  
9 otherwise; because the audit work was completed, KPMG's audit  
10 opinions had been issued, and all that could be done under the  
11 rules was to clean up the work papers to better explain what  
12 the auditors did and to help show the work that had already  
13 occurred.

14 It's like a restaurant, to use the government's  
15 example, keeping their ordinary practice and earning their  
16 grade and then the inspector comes and says, where is the  
17 paperwork for what you did, who you employed, how often they  
18 worked.

19 He permitted this to happen because it was just about  
20 the paperwork. And make no mistake. You'll see it in their  
21 own documents. The PCAOB's view was that it did not give  
22 inspection comments. It did not give failing grades because of  
23 poor documentation. That's why he did it.

24 And third, in February 2017, when Mr. Sweet said he  
25 had all of the audits that the PCAOB was going to inspect later

J2CYMIDT2

Opening - Mr. Boxer

1 that year, Mr. Middendorf reacted differently because at that  
2 time, the audits were still open. The opinions had not yet  
3 been issued. So Mr. Middendorf instructed that no additional  
4 work or resources be added or be done until he conferred with  
5 his boss which he did.

6 When he learned from one of his direct reports that  
7 Mr. Sweet had already been reaching out to engagement partners  
8 whose audits were on the list, he was furious. And he  
9 instructed Mr. Sweet to stop.

10 A week later, Mr. Middendorf and his boss, Scott  
11 Marcello, reported what occurred to the head of compliance.  
12 And right after that, KPMG began an investigation.

13 Mr. Middendorf first spoke with an inside lawyer for  
14 KPMG and then, on three additional occasions, spoke with their  
15 outside lawyers. He shared the important details of what I  
16 just told you about and even acknowledged that in 2016, if he  
17 could, he would have done it differently. He didn't sound like  
18 someone who had gotten caught committing a crime or thought  
19 they committed a crime.

20 Those are the three events, and you heard about it  
21 from me, and you heard about it from the government. What this  
22 trial and what this case is all about is perspective. You must  
23 consider the evidence and the lack of evidence and judge  
24 Mr. Middendorf's intent. That's your role. To do that, to  
25 judge his intent, you need perspective.

J2CYMIDT2

Opening - Mr. Boxer

1           You will hear a lot of testimony and see a lot of  
2 documents about what occurred on just a few days in 2015, 2016,  
3 and 2017. To fairly judge Mr. Middendorf's intent, you must  
4 zoom your perspective out from those three short periods of  
5 time to make sure you examine all of the facts and  
6 circumstances that informed Mr. Middendorf's intent.

7           What do I mean by that. Let me give you a few  
8 examples. Take notice of all of Mr. Middendorf's duties and  
9 responsibilities. After he became the managing partner for  
10 audit quality professional practice in New York, he had almost  
11 200 people reporting to him. Inspections were certainly a very  
12 important area to Mr. Middendorf, but they were not the only  
13 area that he worked on and the only thing that was important to  
14 him.

15           Also -- and this is of critical importance. Consider  
16 Mr. Middendorf's experience with the PCAOB and KPMG's  
17 relationship with the PCAOB. I say this is critical because it  
18 informs Mr. Middendorf's intent and actions.

19           You will hear during the trial that KPMG had an uneasy  
20 relationship with the PCAOB. Some of that was natural, tension  
21 between a regulator and the regulated entity. But some of it  
22 was specific to KPMG.

23           KPMG, for example, disagreed with some of the PCAOB  
24 comments in their inspections. And when they challenged too  
25 many, they were lectured by the PCAOB that they complained too

J2CYMIDT2

Opening - Mr. Boxer

1 much.

2 When he became national managing partner,  
3 Mr. Middendorf wanted to improve KPMG's relationship with the  
4 PCAOB. So unlike his predecessor, he attended the monthly  
5 meetings KPMG had with senior officials at the PCAOB.

6 And at these meetings, Mr. Middendorf and others from  
7 KPMG laid out the work it was doing to improve audit quality,  
8 all the initiatives and all the people and all the money KPMG  
9 was devoting to improve audit quality. And at these meetings,  
10 the PCAOB often complained about how this was not enough.

11 KPMG tried to show the PCAOB that it was doing its  
12 best to improve audit quality, but sometimes it seemed like the  
13 PCAOB only focused on the shortcomings and did not give KPMG  
14 credit for what it was trying to do.

15 In fact, you will learn during the trial that even one  
16 of the PCAOB board members felt that the PCAOB too often played  
17 a game of gotcha instead of acting to improve audit quality,  
18 the PCAOB's stated mission. All of this is perspective we ask  
19 you to bring to your assessment of Mr. Middendorf's intent.

20 Also consider the big picture with regard to the SEC.  
21 You'll learn during the trial that Mr. Middendorf spoke with  
22 the SEC about auditing issues that applied generally, not about  
23 specific comments and particular inspection reports.

24 For example, he met with the PCAOB about a technical  
25 accounting issue, about how much money banks needed to set



J2CYMIDT2

Opening - Mr. Boxer

1     aside as a reserve or an allowance in case loans were not paid  
2     back.

3             The SEC was mostly focused on the companies which  
4     you'll hear are called the issuers who were KPMG's clients.  
5     And as far as Mr. Middendorf's intent, which is where your  
6     focus needs to be, he had no reason to think for example, in  
7     2016, that a review of the papers in the file after the audits  
8     were over and after the audit opinions were issued would  
9     somehow impede or defeat a function of the SEC.

10            When you consider what Mr. Middendorf did and did not  
11     do on the few days at issue and when you take the time to look  
12     at the full perspective, you will conclude that the government  
13     has not proven beyond a reasonable doubt that Mr. Middendorf  
14     intended to defraud the SEC or the PCAOB.

15            Let me take a brief moment to introduce  
16     Mr. Middendorf.

17            Dave, please stand.

18            And seated with us at counsel table are Alex Clark,  
19     Amy Lester, and Greg Bruch. And I know I speak for each of  
20     them when I tell you it is our privilege to represent  
21     Mr. Middendorf.

22            During the trial, I encourage you to pay attention to  
23     not just what is said but also who says it. Take Brian Sweet,  
24     for example. He comes to KPMG highly regarded. You'll see he  
25     knows the auditing rules inside and out.

J2CYMIDT2

Opening - Mr. Boxer

1 But it turns out there is another side to Mr. Sweet  
2 which Mr. Middendorf and KPMG were unaware of at the time he  
3 was hired. He self-promotes his importance; he makes  
4 inspection predictions and receives lists of inspections that  
5 nobody asks him for, including Mr. Middendorf; and he lies. He  
6 lies big time.

7 You'll see in the emails it is Mr. Sweet who's doing  
8 the pumping, not Mr. Middendorf, promoting the access he has,  
9 the information he has, the lunches he went to, and the inside  
10 information he has. It was not Mr. Middendorf asking him to do  
11 that.

12 Is Brian Sweet someone you can rely on to find beyond  
13 a reasonable doubt that Mr. Middendorf committed fraud? I  
14 think you will conclude that you cannot.

15 Also think carefully about the witnesses from the  
16 PCAOB. I'm not suggesting that they will lie. I certainly  
17 expect that they will not. But there is no getting around the  
18 fact that this case has put a spotlight on the PCAOB and its  
19 employees. You should be on the lookout as to whether any  
20 witness displays a bias or exaggerates in a way that's unfair  
21 to Mr. Middendorf.

22 We ask only that you give Mr. Middendorf a fair  
23 hearing, fair consideration. And we are confident that you  
24 will. And after a fair assessment of all of the facts,  
25 including the full picture of Mr. Middendorf's relationships at

J2CYMIDT2

Opening - Mr. Cook

1 KPMG and his experiences with the SEC and the PCAOB, we are  
2 confident that you will conclude that he is not guilty of the  
3 crimes with which he's been charged. Thank you.

4 THE COURT: Thank you.

5 Ladies and gentlemen, you will now hear the opening  
6 statement on behalf of Mr. Wada.

7 Mr. Cook.

8 MR. COOK: Almost exactly two years ago, the PCAOB had  
9 a problem. One of the largest, most well-respected accounting  
10 firms in the world, one of the so-called "Big 4," KPMG was  
11 receiving confidential information from not just one source but  
12 from several sources, former and current PCAOB employees.

13 And among the information that those current and  
14 former PCAOB employees conveyed to KPMG was the 2016 and 2017  
15 inspection lists that you've heard about, information that KPMG  
16 should not have had.

17 The problem for the PCAOB though -- and it would  
18 become a problem for the government shortly afterwards -- was  
19 that there was so much information flowing from within PCAOB  
20 into KPMG from so many different sources.

21 And it wasn't just the sources. KPMG was actively  
22 recruiting PCAOB employees from their inspection division,  
23 offering them massive salary increases if they would quit their  
24 jobs and join KPMG.

25 Of course, when people do that, they bring with them

J2CYMIDT2

Opening - Mr. Cook

1 the information in their head, the information that they learn,  
2 sometimes from years of work at the PCAOB. But in some cases,  
3 as you'll hear, and not just in the case of Brian Sweet, they  
4 download PCAOB information on personal hard drives, they carry  
5 it with them out the door, and then brought it with them to  
6 KPMG.

7 You may have heard the term "revolving door" applied  
8 to people who leave work for a regulator or government agency  
9 and go into private practice to make more money. Sometimes  
10 they go back again and get more experience, and then they go  
11 back again to private practice to make more money. It happens  
12 all the time. It's not uncommon.

13 These people -- when they do that, they develop  
14 relationships. They become friends with the people that they  
15 are working with. They go to lunches. They go to conferences  
16 together. They get to know each other. They work together.

17 Sometimes when they get together, they talk shop.  
18 They talk about their jobs. In some cases, they talk too much.  
19 Brian Sweet is an example of that. Brian Sweet took it to a  
20 whole other level.

21 Brian Sweet vacuumed up every last bit of confidential  
22 PCAOB information he could get, whether he downloaded it to a  
23 personal hard drive, whether he brought it with him in his head,  
24 or whether he recruited sources among current and former PCAOB  
25 employees, he looked for every opportunity to collect

J2CYMIDT2

Opening - Mr. Cook

1 information, and then he would dole it out to KPMG in order to  
2 advance his own career. You will see that evidence in this  
3 trial.

4 For example, KPMG, as part of their efforts to better  
5 prepare for PCAOB inspections, hired a data analytics firm  
6 called Palantir Technologies. That company takes vast  
7 quantities of data, processes it, and spits out predictions  
8 used by firms like the CIA and the FBI to process huge amounts  
9 of information.

10 KPMG hired them to try and predict who the PCAOB was  
11 going to inspect, but it doesn't work if you don't feed raw  
12 information into the machine. So who better to do that than  
13 Brian Sweet.

14 Mr. Sweet was more than happy to sit down with the  
15 representatives of Palantir and provide a complete data  
16 download of everything he knew about how the PCAOB selects  
17 their inspection targets.

18 So the evidence, ladies and gentlemen, will show that  
19 Brian Sweet was willing to give it all up, and not just that.  
20 He got other people to do the same thing, other people  
21 including a woman named Cynthia Holder who you will hear much  
22 about during the trial.

23 As I said, the problem that the PCAOB had was not just  
24 that there was one leak but there were many leaks. When I  
25 mentioned this would become a problem for the government, this

J2CYMIDT2

Opening - Mr. Cook

1 is how.

2 When the government became aware of the leaking and  
3 when they decided to focus on a particular form of confidential  
4 information to prosecute, they had to figure out who the source  
5 was of that particular piece of information from amongst all  
6 the sources that were leaking data.

7 So here's where the evidence is going to get  
8 interesting because the government has chosen, identified, Jeff  
9 Wada as the source of the confidential information that they've  
10 chosen to focus on, the 2016 and 2017 inspections.

11 So they have to prove to you beyond a reasonable doubt  
12 that from amongst all the sources of confidential information  
13 leaking out of the PCAOB, that Jeff Wada was the source of that  
14 information. So how are they going to do that.

15 You got a little bit of a preview. They're going to  
16 show you text messages, emails, a couple of voicemail messages,  
17 and they're going to show you a lot of phone records. The  
18 problem with all of that evidence -- and I urge you to pay  
19 close attention to it -- is you will not find a single  
20 reference to the 2016 or 2017 inspections, not one.

21 It's a huge hole in their case; right? They've got to  
22 show that Mr. Wada was the source of this information. They  
23 have all these records, but there is no context for them  
24 because there is no recordings of these phone calls. The text  
25 messages and the emails don't say anything about confidential

J2CYMIDT2

Opening - Mr. Cook

1 information. So how are they going to fill that hole.

2 In a couple of days, you're going to hear how they're  
3 going to attempt to do that, and that's going to be with the  
4 testimony of Brian Sweet. So Brian Sweet is essentially going  
5 to tell you that Cynthia Holder told him that Jeff Wada told  
6 her the names on these inspection lists.

7 The government is going to use Brian Sweet as a  
8 narrator to a silent movie, silent because what he's attempting  
9 to narrate are records that don't contain any information about  
10 conversations that he was never a party to.

11 But they're going to use him to try and sew them all  
12 together to try to create a link to Mr. Wada. So you're going  
13 to see in Mr. Sweet's testimony an attempt to fill this gap in  
14 their case.

15 Here's what else you're going to hear about Mr. Sweet,  
16 and I'll make a prediction. You're going to hear it from the  
17 government themselves. I won't even have to ask Mr. Sweet  
18 about anything of this.

19 You'll hear about his fondness for lying. He loves to  
20 lie. It's not going to be an issue. He'll admit it. He lies  
21 to his coworkers. He lies to his former employers. He lied to  
22 the KPMG lawyers that he met with about this case.

23 He lied to the federal agents investigating this case,  
24 and he lied to these prosecutors, all of them, repeatedly, over  
25 and over again. And they believed him. You're going to hear

J2CYMIDT2

Opening - Mr. Cook

1 about all of that.

2 You're also going to hear about Brian Sweet's crimes.  
3 When I say "crimes," I'm not just talking about the crimes that  
4 he was required to plead guilty to as part of the deal the  
5 government gave him. You're going to hear that as part of that  
6 deal, he had to confess to some of his other crimes, other  
7 felonies. You're going to hear about those.

8 Then you're going to hear that after weeks and  
9 sometimes months of lying to these prosecutors and the agents  
10 responsible for this case, that when he was about to be found  
11 out not by the agents but by defense counsel about other  
12 felonies he had committed, then he had to fess up to those too.

13 Crime after crime after crime, lie after lie after  
14 lie -- you're going to hear about all of that, and I predict  
15 much of it will be during the government's own examination of  
16 their lead cooperator. If they don't, we'll ask him.

17 As the Judge said, you are the judges of the facts.  
18 You determine the credibility of the witnesses. You will  
19 decide whether you can rely on Brian Sweet's testimony beyond a  
20 reasonable doubt.

21 I'm confident that once you hear the evidence, you  
22 hear his testimony, you see all these records in front of you,  
23 that you will conclude that the government has failed to meet  
24 its burden of proving beyond a reasonable doubt that Jeff Wada  
25 was the source of that confidential information.



J2CYMIDT2

Opening - Mr. Cook

1 Ladies and gentlemen, that is only part of the problem  
2 with the government's case. But let me just pause there for a  
3 minute. We had a very long day yesterday. I know that we were  
4 introduced briefly to you. I want to do that again now.

5 My name is Steve Cook, and together with my  
6 colleagues, Justin Weddle, Jason Ohta, and Selbie Jason, we  
7 have the privilege of representing Mr. Wada.

8 Mr. Wada was born and raised in California, went to  
9 high school outside of Los Angeles, and college at UCLA where  
10 he graduated in 1997 with a degree in economics. He went on to  
11 work for a large public accounting firm, not KPMG, where he  
12 became a certified public accountant working here in New York  
13 and also in Los Angeles. He joined the PCAOB in February 2005.  
14 And in 2012, he was promoted to the position of inspections  
15 leader.

16 Mr. Wada is married to Marion Wada. You may see her  
17 name in some of the phone records today. Marion and Jeff have  
18 two young children. I want to tell you a little bit about his  
19 personality. I'm doing it not to embarrass him, but you'll get  
20 a flavor of that during this trial.

21 Jeff can be a bit rough around the edges. He's very  
22 vocal in his opinion, and he can use colorful and sometimes  
23 crude language when he's talking to people he considers his  
24 friends. You may see some of that in his emails and text  
25 messages.

J2CYMIDT2

Opening - Mr. Cook

1           You'll also hear that he was quite vocal about him  
2 being upset that he got passed over for a promotion at the  
3 PCAOB, and he expressed that frustration again to his friends  
4 in his own uniquely colorful way.

5           Why am I telling you this? I'm telling you this  
6 because Mr. Wada's personality is not on trial here. It is not  
7 evidence of whether he committed a fraud. But that does lead  
8 us to the other problem with the government's case. And before  
9 I start this, before I talk about that, I need to make one  
10 thing clear.

11           You don't even get to this problem unless you first  
12 conclude that Mr. Wada was actually the source of this  
13 information. And as I've said before, I submit that the  
14 government will not be able to prove that.

15           But for the sake of our conversation, let's just  
16 assume a fanciful hypothetical that they were able to prove  
17 that Mr. Wada was the source of the 2016 and 2017 inspection  
18 lists.

19           A big part of this case -- you heard some of this  
20 already -- is about the difference between a wrong, doing  
21 something that's wrong, and committing a crime, doing something  
22 that might be unethical or even immoral and a crime.

23           And you may be thinking to yourself, what's the  
24 difference. There isn't a difference. And in many cases, you  
25 would be absolutely right. Many things that are both unethical

J2CYMIDT2

Opening - Mr. Cook

1 and immoral and wrong are also crimes, but why are they crimes?  
2 They are crimes because Congress, who are our elected  
3 representatives, have chosen to criminalize that particular  
4 conduct.

5 Now, I'm not saying that doing something wrong or  
6 immoral or unethical is okay. I'm not saying it shouldn't even  
7 be punished. What I'm saying is this is a federal criminal  
8 trial. Mr. Wada is charged with violating federal law. He is  
9 not charged with doing something unethical or immoral because  
10 that on its own is not a crime.

11 For example, if the government were able to prove that  
12 Mr. Wada was the source of these inspection lists, he would  
13 have violated the PCAOB's policies and procedures, specifically  
14 ethics code number 9.

15 Does that make his conduct criminal? Does that mean  
16 that he committed fraud on its own? No. It does not. The  
17 government is required to prove more than there was a workplace  
18 violation, more than he did something wrong or unethical or  
19 immoral.

20 And it is not your job as jurors, as the Court will  
21 explain, to decide whether somebody should lose their job, lose  
22 their license, be punished in some other way. Your job is to  
23 decide whether the government has proven the elements of these  
24 crimes beyond a reasonable doubt.

25 So what do they have to prove in order to prove fraud,

J2CYMIDT2

Opening - Mr. Cook

1 because that's what they've charged Mr. Wada with. The  
2 government must prove beyond a reasonable doubt that Jeff Wada  
3 had the specific intent in his mind at the time he supposedly  
4 gave this information over to defraud the Securities and  
5 Exchange Commission and to defraud the PCAOB.

6 They have to prove what his intent was, what he meant  
7 when he did it. And I urge you to pay close attention to the  
8 evidence. I submit you will not see a shred of evidence that  
9 Mr. Wada gave even a passing thought to the SEC, much less that  
10 he joined a conspiracy to deliver confidential information with  
11 the specific intent in his mind to defraud that agency. I  
12 submit you will see no evidence of that. But look for it.

13 Similarly, you will see no evidence that anything  
14 Mr. Wada did, that when he did it, he had the specific intent  
15 to defraud the PCAOB. Look for that. I submit you will not be  
16 able to find it. And in a fraud case like this, that, ladies  
17 and gentlemen, is what reasonable doubt looks like.

18 A couple of comments concerning the two conspiracy  
19 charges, conspiracy to defraud the SEC and conspiracy to  
20 defraud the PCAOB. Look for any evidence, any evidence at all,  
21 that Mr. Wada joined a conspiracy with a group of conspirators  
22 that include people that he's never met and never had any  
23 communication with in order to engage, embark upon, a fraud of  
24 the SEC. Look for that. I submit you will not find it.

25 Look for any evidence that Jeff Wada joined a group of

J2CYMIDT2

Opening - Mr. Cook

1 mostly strangers with the specific intent to commit a felony to  
2 defraud the PCAOB because that's what they've charged. I  
3 submit you will not find any evidence of that.

4 Just a couple of final thoughts before we get started  
5 with this trial. You've already heard the phrase "presumption  
6 of innocence" many times. You've heard the phrase "beyond a  
7 reasonable doubt" many times already. Every day of this trial,  
8 Jeff Wada, as he sits here now -- he is an innocent man. Every  
9 single day that he comes and you see him in this courtroom, he  
10 remains an innocent man.

11 When the parties rest their case and they begin their  
12 closing arguments, he will and must in your mind remain an  
13 innocent man because that's what the law requires.

14 And he remains an innocent man up until the time you  
15 enter your deliberations. And only then can you and should you  
16 begin your deliberations and begin your evaluation of the  
17 government's evidence. But up until that point, he must remain  
18 in your mind an innocent man.

19 And I know that that is not a way we're used to  
20 thinking about things. We go about our daily lives. We make  
21 decisions every day. We interact with people on the street.  
22 We make judgments.

23 We don't use a reasonable standard, and we don't  
24 always presume people to be innocent until they're proven  
25 otherwise to us. It's just not part of the way we function.

J2CYMIDT2

Opening - Mr. Cook

1 But this is a criminal prosecution in federal court.  
2 This is not ordinary life. This is different. So you have to  
3 adjust your mindset to this reality. And the reality requires  
4 us, the law -- the Constitution requires us to presume that  
5 he's innocent until they meet their burden beyond a reasonable  
6 doubt. There will be a time for judgment, but that time is not  
7 until the end of this case.

8 On behalf of Mr. Wada, I want to thank you for your  
9 service. We all know jury service isn't easy. We know you  
10 have busy lives, jobs, families. We heard a lot about it  
11 yesterday. We recognize the sacrifice that you're making.

12 Please remember that your service on this jury will be  
13 one of the most important things you will ever do. Certainly  
14 for Mr. Wada, these are the most important weeks of his life.  
15 So we thank you for your willingness to serve and for your  
16 careful and impartial consideration of the case.

17 THE COURT: Thank you.

18 Ladies and gentlemen, you've now heard the opening  
19 statements of the lawyers on behalf of each of the parties. I  
20 want to say a couple things about going forward. We'll now  
21 begin the evidence in the case consisting of witnesses and  
22 documents that will be received in evidence.

23 We've handed out notebooks for you, and I want to say  
24 a couple things about the notebooks. Those are for yourselves.  
25 Each juror may choose to take notes. Some people find it

J2CYMIDT2

Opening - Mr. Cook

1 helpful.

2           You're not required to take notes, and I'm going to  
3 ask that you not show your notes to each other or to anyone  
4 else. You'll be leaving your notes every day -- if you do take  
5 them, you'll be leaving your pads on your chairs. You will not  
6 be taking them home or anywhere else.

7           And only when the jury begins deliberating will you be  
8 allowed to take any notes you might have taken back to the jury  
9 room. After the trial, we'll destroy the notes. You won't be  
10 taking them anywhere else.

11           I'm going to ask you not to show them to each other.  
12 They're just for your own aid and recollection if you choose to  
13 take notes. The fact that one person takes notes does not mean  
14 that that person is entitled to any greater consideration than  
15 anybody else.

16           Every juror is treated equally in terms of their  
17 views. You might not take notes; you might take notes. It's  
18 up to you. If you have any difference in your recollection  
19 between what happened, it's your recollection that controls,  
20 not any particular person's notes, your recollection of the  
21 actual testimony.

22           As I'll explain later in the trial, if you do need  
23 testimony read back when you are deliberating, I will be able  
24 to do that. You'll also have the exhibits that are received in  
25 evidence back in the jury room with you. So don't feel like

J2CYMIDT2

Opening - Mr. Cook

1 you have to copy everything down.

2 Before we begin with the first witness, does anybody  
3 need a break? Should we take a ten-minute break? Do you all  
4 need a bathroom break? Ten minutes?

5 Okay. We'll take a ten-minute break. Then we'll  
6 begin with the first witness.

7 (Continued on next page)

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J2CYMIDT2

Opening - Mr. Cook

1 (In open court; jury not present)

2 THE COURT: You may be seated.

3 The government's first witness will be?

4 MS. KRAMER: Wesley Bricker, your Honor.

5 Shall I put him on the stand before the jury comes  
6 back in, or would you like him to remain inside the courtroom  
7 until the jury is seated?

8 THE COURT: I'm fine with putting him on the stand.  
9 Do you have a preference either way?

10 MS. KRAMER: I think I'll put him on the stand so  
11 we're not waiting for him to make the long walk from the door.

12 THE COURT: Sounds good.

13 MS. KRAMER: Thank you, your Honor.

14 THE COURT: Thanks.

15 (Recess)

16 (Continued on next page)

J2C5mid3

Bricker - direct

1 (Jury present)

2 THE COURT: Welcome back, ladies and gentlemen.

3 JUROR: Thank you.

4 THE COURT: We will begin the evidence in the case  
5 now.

6 Ms. Kramer, the government may call its first witness.

7 MS. KRAMER: Thank you, your Honor. The government  
8 calls Wes Bricker.

9 THE COURT: Sir, would you please stand and raise your  
10 right hand? You will be sworn in.

11 WESLEY RAY BRICKER,

12 called as a witness by the Government,

13 having been duly sworn, testified as follows:

14 DIRECT EXAMINATION

15 BY MS. KRAMER:

16 Q. Good morning, Mr. Bricker.

17 A. Good morning.

18 Q. Where do you work?

19 A. The Securities and Exchange Commission.

20 Q. Is that known as the SEC?

21 A. It is.

22 Q. Throughout your testimony, other than when I indicate to  
23 you that I am asking you about a specific point in time, I  
24 would like you to answer my questions for the time period 2015  
25 through 2017. Okay?

J2C5mid3

Bricker - direct

1 A. Okay.

2 Q. What is the SEC?

3 A. The SEC is a regulatory agency.

4 Q. Is it part of the federal government?

5 A. It is.

6 Q. Who runs the SEC?

7 A. The SEC is run by five commissioners with a chair. The  
8 chair has administrative responsibilities for the Commission.

9 Q. What is your role at the SEC?

10 A. My role is to serve as the chief accountant for the SEC.

11 Q. In general terms, what are your duties and responsibilities  
12 as the chief accountant at the SEC?

13 A. In general terms, my responsibilities are to provide advice  
14 and recommendations to the Commission on accounting, audit,  
15 other professional practice matters.

16 Q. Do you work in a particular office or division within the  
17 SEC?

18 A. I do.

19 Q. Which one?

20 A. It's the office of the chief accountant.

21 Q. Is that known as OCA?

22 A. It is.

23 Q. Approximately how many other people work in OCA?

24 A. Approximately 50 in OCA.

25 Q. Who do you report to at the SEC?

J2C5mid3

Bricker - direct

1 A. I report to the Chair of the Commission.

2 Q. For approximately how long have you worked at the SEC?

3 A. I've been at the SEC since 2015, so approximately just over  
4 three years.

5 Q. Before working at the SEC, where were you employed?

6 A. Prior to the SEC I was at the accounting firm  
7 PricewaterhouseCoopers, or PWC.

8 Q. During approximately which years?

9 A. I was there for two periods. I was there from 2011 until  
10 joining the SEC in 2015, and then I was there earlier in my  
11 career from 2000 until 2009.

12 Q. And where did you work between 2009 and 2011?

13 A. I worked at the SEC.

14 Q. What was your role at the SEC between 2009 and 2011?

15 A. I was in the Office of the Chief Accountant as well but  
16 with the responsibilities of a professional accounting fellow.

17 Q. What does a professional accounting fellow do?

18 A. A professional accounting fellow is someone who focuses on  
19 accounting or audit or both. In my case I focused on primarily  
20 accounting but included audit matters as well.

21 Q. When you rejoined the SEC in 2015, what was your role?

22 A. I rejoined as the Deputy Chief Accountant with a focus on  
23 the accounting issues. So, I was the deputy chief accountant  
24 leading the accounting group.

25 Q. When did you become the chief accountant?

J2C5mid3

Bricker - direct

1 A. I became the chief accountant in 2016.

2 Q. What is your educational background?

3 A. I am educated as an accountant. I have a bachelors degree  
4 in accounting. I am also educated as a lawyer, I have a law  
5 degree.

6 Q. Do you have any professional licenses or certifications?

7 A. I do. I am certified as a public accountant, a CPA. I am  
8 also a member of the New York Bar.

9 Q. Have you ever practiced law?

10 A. I have not.

11 Q. In what states are you licensed as a certified public  
12 accountant or CPA?

13 A. Currently I'm licensed in New Jersey, in Pennsylvania, and  
14 in Virginia.

15 Q. In connection with maintaining your CPA license, do you  
16 receive ongoing training?

17 A. I do.

18 Q. What kind?

19 A. It is referred to as continuing professional education.

20 Q. Do all registered CPAs have to receive continuing  
21 professional education?

22 A. Yes. All licensed CPAs are subject to continuing  
23 professional education requirements in order to maintain an  
24 active license.

25 Q. In addition to the continuing professional education that

J2C5mid3

Bricker - direct

1 you receive, do you also receive training on issues relating to  
2 your job?

3 A. I do.

4 Q. What kind of training do you receive?

5 A. I receive training from conferences from the SEC regarding  
6 a variety of topics from management topics to market topics and  
7 technical topics.

8 Q. Do you also provide training to others?

9 A. I do.

10 Q. What kind of training do you provide?

11 A. I am a speaker at conferences, professional conferences,  
12 panels generally on accounting, audit, or markets issues.

13 Q. When was the SEC established?

14 A. The SEC was sustained in 1934.

15 Q. What's your understanding of why it was established?

16 A. It was established as a result of the legislative fixes to  
17 the great depression and the market crash within the stock  
18 market.

19 Q. Is the SEC divided into divisions and offices?

20 A. It is. It's divided into roughly 20 divisions and offices.

21 Q. I am going to ask you to just move the microphone a little  
22 bit closer to you so that your volume doesn't drop off at the  
23 end of your sentence.

24 What divisions or offices within the SEC do you  
25 interact with most frequently as chief accountant?

J2C5mid3

Bricker - direct

1 A. Generally speaking, I most frequently interact with the  
2 Division of Corporation Finance, Division of Investment  
3 Management, Division of Trading and Markets, Division of  
4 Enforcement, as well as offices; Office of Compliance,  
5 Inspections and Examinations.

6 Those are just examples.

7 Q. Does the SEC have a mission?

8 A. It does.

9 Q. What is the SEC's mission?

10 A. The SEC's mission is really three parts. The first part is  
11 to protect investors who participate in our markets. The  
12 second part of the SEC's mission is to foster or promote  
13 capital formation, which is the ability of companies to access  
14 our markets. And then, the third piece is the fairness or the  
15 efficiency within our markets.

16 So, it is all three parts.

17 Q. In simple terms, what is investor protection?

18 A. In very simple terms, investor protection means to the SEC  
19 providing or fostering a market where investors receive the  
20 information that they need in order to make investment  
21 decisions. So, it's the honesty, the accuracy, and the  
22 completeness of the information that investors need so they can  
23 make decisions that work for them and that fit them best.

24 Q. And, in very simple terms, what does it mean to promote  
25 capital formation?

J2C5mid3

Bricker - direct

1 A. So that's, in very simple terms, that's a concept of  
2 helping companies to be able to get the money that they need in  
3 order to grow their businesses, in order to compete, in order  
4 to hire workers. So, businesses need money and the term we use  
5 for that is capital formation.

6 Q. And lastly, in simple terms, what does it mean to foster  
7 fair and efficient markets?

8 A. So, in very simple terms, that's a concept of enabling  
9 investors to sell their investments to some other person in a  
10 market that is fair and in a market that is efficient.

11 Q. Let's turn to some fundamentals.

12 Generally, what is a public company?

13 A. Generally speaking, a public company is a company that the  
14 general public owns at least a portion of.

15 Q. How do members of the general public own a portion of a  
16 public company?

17 A. So, members of the public can own a portion of a company by  
18 buying a share of a company's stock.

19 Q. Can you give an example of a public company that issues  
20 stock?

21 A. An example would be the Coca-Cola Corporation. They've  
22 offered investments in their company and individuals can buy  
23 those investments, those stock investments.

24 Q. Does the SEC require public companies like Coca-Cola to  
25 file anything with the SEC on an annual or yearly basis?



J2C5mid3

Bricker - direct

1 A. The SEC does. The SEC requires those companies to file an  
2 annual report. An annual report contains information about the  
3 company and continues to update investors about that company as  
4 they evaluate whether to buy more, continue to hold, or even  
5 sell their stock.

6 Q. What is the name for the part of that annual report that  
7 reflects a company's financial affairs or financial health?

8 A. So, the portion of the annual report that includes the  
9 financial pieces is generally referred to as the financial  
10 statements.

11 Q. When a public company files its annual financial statements  
12 with the SEC, are those financial statements then available  
13 just to the SEC or also to the public?

14 A. Those disclosures and that financial statement is available  
15 to everyone. It's also, of course, available to the SEC, so  
16 it's the SEC and everyone.

17 Q. How are financial statements for public companies made  
18 available to the public? What are the mechanics of that?

19 A. It is made available through the SEC's website, so  
20 companies upload their financial statements to the SEC system  
21 and then anyone can access those disclosures and those  
22 documents through the SEC's website.

23 Q. Do members of the general public have to pay to access  
24 financial statements or can they access them for free?

25 A. Free. Entirely free.

J2C5mid3

Bricker - direct

1 Q. In broad terms, what kind of information is made available  
2 to the public in a company's annual financial statement?

3 A. The kinds of information included in the financial  
4 statement would include things like the amount of money that a  
5 company owes to other people, as well as what a company owns.  
6 So, that's generally referred to as the balance sheet. It  
7 gives you a snapshot of, again, what the company owns and what  
8 it owes to other people. The financial statements also  
9 include, for the period, the amount of sales that that company  
10 has made as well as its expenses associated with those sales.  
11 So, for example, if it's Coca-Cola, the amount of beverages  
12 that it has sold, as well as the cost associated with those  
13 beverages.

14 Those are just examples of what's included in the  
15 financial statements.

16 Q. Do annual financial statements for public companies contain  
17 just objective facts like the number of cans of soda that have  
18 been sold? Or do they also contain more subjective  
19 information?

20 A. It includes both; some real sort of objective information  
21 like the number of cans or amount of cash in the bank account,  
22 but it also includes subjective amounts that require estimation  
23 and judgment by accountants.

24 Q. So, take, for example, a company that sells cell phones.  
25 Can you give an example of the kind of subjective information

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Bricker - direct

1 that would be in that cell phone company's financial  
2 statements?

3 A. So, a company that sells cell phones, in this example it  
4 would be a company that has cell phones in its inventory and so  
5 it would be -- it would need to measure the amount of cell  
6 phone inventory it has but it would have to take care to not  
7 overstate the value of those phones and so it would need to  
8 consider if there is a later or newer model of phone, or if  
9 there is a competitor whose phone is selling much better than  
10 that company's own phones.

11 And so, that's part of the subjective element, is  
12 really thinking about what the value of the phones are to  
13 report in the financial statements so that when investors  
14 receive that information they have good insight into the value  
15 of the phones so that they incorporate that into their  
16 investment decision.

17 Q. So, to continue with the example, how does the fact that a  
18 competitor has a new model phone affect the decision about how  
19 much value to assign to older model cell phones?

20 A. So, in the cell phone example, if a company has older  
21 technology and another competitor has newer technology, it  
22 might need to reduce or take a writedown on the value of those  
23 older phones reflecting the fact that when it sells those, its  
24 phones, the older phones, it would have to discount those in  
25 order to provide enough incentive for customers to buy the

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Bricker - direct

1 older models.

2 Q. What part of a company's financial statements does the  
3 value of those older phones go into?

4 A. So, it goes into the assets of the company, the more  
5 technical reference to that statement is the balance sheet and  
6 the balance sheet, again, reflects the assets that the company  
7 has, as well as the amount that it owes and its equity but it  
8 is in the assets section.

9 Q. Let's look at another example in a different industry. Can  
10 you give an example of the kind of subjective information that  
11 goes into financial statements for a public company that gives  
12 people mortgages to buy homes, a company that makes loans?

13 A. Sure.

14 So, a company that makes loans, that might be a bank.  
15 So, when a bank makes a loan -- a mortgage loan -- it gives the  
16 borrower cash, and in exchange it has a promise that the  
17 borrower will repay. The value of the loan that is made is  
18 reported by the bank in its balance sheet as an asset because  
19 it's counting on the borrower repaying the bank.

20 Q. So, in figuring out how much that loan is worth, how much  
21 the bank or the lender expects to get back, can you give some  
22 examples of the kinds of things that the bank or the lender  
23 would consider in trying to get to that number?

24 A. Yes.

25 So, the bank would need to think about whether the

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Bricker - direct

1 borrower has the ability to repay the loan, and in thinking  
2 about that they would, the bank would need to think about  
3 whether the borrower has, still has their job or whether  
4 they've lost their job. They would also need to think about  
5 the value of collateral for the loan. So, for example, if it's  
6 a home loan mortgage, the house serves as collateral for the  
7 loan and so the bank would need to think about whether the  
8 house is still in good condition or, for example, if there has  
9 been a natural disaster like flooding or a hurricane or  
10 something that has damaged the value of the house.

11 All of those things would go into the ability of the  
12 borrower to repay the bank.

13 Q. Is there an accounting term for the amount that the value  
14 of that loan has to be reduced in the financial statement to  
15 reflect that risk of the lender not getting paid back?

16 A. Yes.

17 So, the terminology that accountants use in that case  
18 can be various but the common terminology is the Allowance for  
19 Loan Losses or the Allowance for Loan and Lease Losses, and  
20 then even that is abbreviated as capital A capital L-L, so ALL,  
21 or ALLL. What that represents is the company's estimate or  
22 measurement of the amount of money that they expect to loose on  
23 their loans.

24 Q. So, just to illustrate, can you give an example of how  
25 that, the allowance or the ALL, is reflected in a financial

J2C5mid3

Bricker - direct

1 statement if you were just talking about, for example, a  
2 \$100,000 loan, a single loan for \$100,000?

3 A. Sure.

4 So, in that case a single loan of \$100,000, what you  
5 would see in the financial statements is you would see \$100,000  
6 and then let's just say that the bank expected to lose \$10,000  
7 on that loan so you would see \$100,000 and then minus \$10,000  
8 equals \$90,000. That \$10,000 of reduction would be the amount  
9 that the bank doesn't expect will be received on the loan and  
10 investors then have access to information regarding the amount  
11 of loans that the bank has made, that's the \$100,000, also what  
12 the bank doesn't expect to collect on those loans, that's the  
13 \$10,000, and then the net amount which is \$90,000. That is  
14 sort of the remaining amount and then investors can then have a  
15 sense of that information when they make a decision about  
16 whether to invest in that company.

17 Q. Now, I just gave you an example using a single loan. Do  
18 financial statements generally contain a calculation of the  
19 allowance for a single loan or for groups of loans or for  
20 something else?

21 A. The financial statements will reflect that sort of core  
22 concept for all of the bank's loans so it is a total number.  
23 It is all of its loans added up into a single amount and then  
24 it's all of the amounts that it doesn't expect to collect added  
25 up into a single amount, and then you get, doing the long math,

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Bricker - direct

1 a hundred in our example minus 10 equals 90. But, that's the  
2 amount for all of the loans that the bank has made.

3 Q. What is an auditor?

4 A. An auditor is someone who is independent of the company and  
5 who audits the financial statements, so in other words someone  
6 independent of the company who checks the financial statements.

7 Q. And you say someone who checks the financial statements, we  
8 will get into this shortly, but how long does that check  
9 typically take for a large public company?

10 A. For the largest of companies that process occurs at the  
11 start of the company's year so the checking really never stops  
12 and that's important so that the audit process is completed  
13 whenever management is required to issue its financial  
14 statements. That is to say, the audit occurs -- for large  
15 companies the audit occurs throughout the year at the same time  
16 as the company is operating its business.

17 Q. Are you familiar with something called an auditor's report?

18 A. I am.

19 Q. What is that?

20 A. An auditor's report is a report that's included with the  
21 financial statements so that investors have both the company's  
22 financial statements, then they also have the auditor's report  
23 and they can see both of those things at the same time.

24 Q. What are the main parts of a standard auditor's report?

25 A. Standard auditor's report really starts with the auditor

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Bricker - direct

1 communicating what they've audited. So, if they've audited a  
2 particular year, a particular set of financial statements,  
3 that's the first part. And then the second part of the report  
4 describes what an audit is so that investors really can  
5 understand what the auditor did in the course of the audit.  
6 And then the last part is the auditor's opinion about having  
7 done the work that they described they had done on the  
8 particular financial statements that they've identified, what  
9 is their opinion about that.

10 Q. What are the different kinds of opinions an auditor can  
11 give on a company's financial statements?

12 A. An auditor really has three approaches. The common one is  
13 referred to as an unqualified opinion, and what that means is  
14 the auditor has looked at the financial statements, they've  
15 done a full scope audit, and then they've reached an opinion  
16 that the financial statements are fairly presented according to  
17 the rules that applied in preparing those financial statements.  
18 So, that's like the clean bill of health for financial  
19 statements.

20 The second type of opinion is where there was some  
21 reason why the auditor wasn't able to express that opinion.  
22 That's referred to as a qualified opinion. That is, the  
23 auditor has engaged in the audit and perhaps there was some  
24 aspect of the company's records that wasn't available, they  
25 couldn't look at, or when they looked at those records, the



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Bricker - direct

1 financial statements weren't prepared properly and so the  
2 auditor is communicating a qualification. So, that's not a  
3 clean bill of health, that's spotting an issue and then  
4 reporting it.

5 And then the last option is referred to as a  
6 disclaimer. What that means is the auditor really couldn't do  
7 even enough work to have an opinion at all and so it's  
8 communicating to investors that they tried to do an audit, they  
9 couldn't complete the audit, and so it they can't express, in  
10 that case, an opinion.

11 Q. What does the clean bill of health opinion typically say,  
12 in short form?

13 A. In short form and sort of simple terms what it says is that  
14 we have conducted an audit and expressed the opinion that the  
15 financial statements are fairly presented in all material  
16 respects in relation to the financial reporting framework that  
17 is required to be applied. So, that might be U.S. GAAP, which  
18 refers to a financial reporting framework or one of the others.

19 Q. You said GAAP. Is that G-A-A-P?

20 A. It is. It is a technical term for accountants. GAAP,  
21 Generally Accepted Accounting Principles.

22 Q. What are generally accepted accounting principles?

23 A. Generally accepted accounting principles are the rules of  
24 the road for accountants.

25 It is generally accepted in the sense that accountants

J2C5mid3

Bricker - direct

1 and others have gotten together and they have agreed on how to  
2 measure things, how to report things, what are the items that  
3 should be in the financial statements, how should they be  
4 communicated. So, it is generally accepted in that sense that  
5 accountants generally agree on an approach. They're  
6 accounting, so it is dealing with accounting, and then the P  
7 word, principles, it is written at a principles level because  
8 accountants have to set out those rules of the road. But, for  
9 every company, they'll have very specific circumstances that  
10 they need to deal with. So, it is Generally Accepted  
11 Accounting Principles.

12 Q. Are there generally accepted accounting principles that  
13 apply to things like calculating that allowance for loan  
14 losses, the ALL that you were testifying about a few minutes  
15 ago?

16 A. Yes.

17 The topic of how to measure that and how to report  
18 that is included within Generally Accepted Accounting  
19 Principles as well as sort of related rules and guidance.

20 Q. What is your understanding of why the general public can  
21 rely on the accuracy of a public company's financial statements  
22 in deciding where to invest?

23 MR. BOXER: Objection. Foundation.

24 MS. KRAMER: Sorry. What was the objection?

25 THE COURT: Foundation.

J2C5mid3

Bricker - direct

1 BY MS. KRAMER:

2 Q. Do you have an understanding of whether or not the public  
3 can rely on financial statements that are filed with the SEC  
4 with auditors' reports and deciding where to invest?

5 A. I do it as part of my job as the chief accountant.

6 Q. What is your understanding of that?

7 MR. BOXER: Objection.

8 THE COURT: Overruled.

9 You can answer.

10 A. My understanding of the foundation for public companies is  
11 really grounded in federal law, as well as the accounting  
12 principles -- GAAP -- that whole framework for accountants that  
13 guide accountants on how to prepare the financial statements  
14 sort of on the one hand that's the company's responsibility.  
15 They have to prepare their financial statements. And then the  
16 other source that provides a foundation for the investing  
17 public to have confidence those numbers is the audit process,  
18 the independent check on what management and the company has  
19 done whenever they've prepared those financial statements.

20 So, those two structural pieces of that information,  
21 which is provided to the public, is really the foundation for  
22 confidence that the public can have.

23 MR. BOXER: Move to strike, your Honor, and also as  
24 non-responsive.

25 MR. WEDDLE: We join in that, your Honor.

J2C5mid3

Bricker - direct

1 THE COURT: Overruled.

2 BY MS. KRAMER:

3 Q. Is there a typical time -- withdrawn.

4 Are you familiar with the term Internal Control over  
5 Financial Reporting?

6 A. I am.

7 Q. Is that abbreviated as ICFR? To add another abbreviation  
8 to the mix.

9 A. It is.

10 Q. What does Internal Control over Financial Reporting, or  
11 ICFR mean?

12 A. So, Internal Control over Financial Reporting is a term  
13 that accountants use to describe that process that companies go  
14 through in preparing their financial reports. So, it's  
15 internal, that's referring internal to the company and it's the  
16 controls, it's the areas within the company that provide  
17 reasonable assurance that the financial reports are prepared in  
18 a complete, accurate, and reliable way.

19 Q. Could you give an example of a simple internal control used  
20 by a public company?

21 A. A very simple one for large companies, large companies,  
22 when they write very large checks sometimes, and a good control  
23 for writing large checks, is to make sure that two people have  
24 signed that check to validate that it is an authorized  
25 disbursement of the company's funds. So, it is not just one

J2C5mid3

Bricker - direct

1 person, it is two people sort of vouching for the  
2 appropriateness of that disbursement.

3 Q. Is there such a thing as an audit after a company's  
4 Internal Control over Financial Reporting, or ICFR?

5 A. Yes.

6 Q. What companies generally have such audits?

7 A. The largest of companies have those audits. So, it's an  
8 audit in those cases, both of the processes, the company's  
9 process for preparing its financial statements as well as the  
10 financial statements themselves. And in that sense it's an  
11 audit that integrates both how the company has prepared its  
12 financial statements as well as the outcome of that process,  
13 which is the financial statements themselves.

14 Q. And is there a term for an audit of both the financial  
15 statements and the company's internal controls over financial  
16 reporting?

17 A. Yes. It's referred to as an integrated audit because it is  
18 integrating the audit of that process with the results of the  
19 process which is the financial statements. It's an audit plan  
20 that is integrated and so it's referred to as an integrated  
21 audit.

22 Q. In an integrated audit, in addition to the opinion on the  
23 financial statements, is there an opinion issued on the  
24 Internal Control over Financial Reporting?

25 A. Yes. There are two opinions in that instance.

J2C5mid3

Bricker - direct

1 Q. And what are the different types of opinions an auditor can  
2 give over a company's internal controls over financial  
3 reporting or ICFR?

4 A. Roughly the same construct, which is the auditor could  
5 conclude that the internal controls are effective in both their  
6 design as well as the way the company has implemented those  
7 controls so that would be an unqualified. But, similar to the  
8 financial statements, if there is some limitation to the  
9 auditor's work, then they would qualify it. They would also  
10 qualify it if, in fact, they did the audit and it turned out  
11 that the controls weren't properly designed. Or, if the  
12 controls really weren't operating effectively, then they would  
13 have the opinion that the internal controls are ineffective.  
14 If the auditor couldn't complete its work, then the auditor  
15 would need to disclaim again.

16 Q. Did you say it would need to disclaim again?

17 A. It would need to disclaim, essentially saying that it tried  
18 to do the work but wasn't able to complete it.

19 Q. In the second category of opinions you just talked about  
20 where there is something wrong with internal controls, what  
21 type of opinion, what language in the opinion is then used?

22 A. So, the type of language within the opinion would be that  
23 the auditor has concluded that internal controls are not  
24 effective and then they would describe the reason -- reason or  
25 reasons that have been identified that results in the internal

J2C5mid3

Bricker - direct

1 controls not being effective.

2 Q. And what does the opinion say if there is just something  
3 wrong with the internal controls?

4 A. So, if there is something wrong then that is described as a  
5 material weakness in internal controls. That's a technical  
6 term but in essence what that is saying is something  
7 significant, important to the objective wasn't present or it  
8 wasn't operating and so it was material in the sense that it  
9 was important and it was a weakness. It was a weakness in that  
10 overall system of controls and then the opinion would lay out,  
11 much more specifically, what the nature of that circumstance  
12 was.

13 Q. So, to use the signing of the check example that you  
14 testified about a few minutes ago, what are the ways in which  
15 that control, the two people signing the check, can present a  
16 material weakness?

17 A. Sure.

18 So, there could be two ways. One way would be if the  
19 company really didn't have such a procedure and it really  
20 needed to have a procedure where for large disbursements two  
21 people needed to sign the check, let's say a company just  
22 didn't have that within its procedures manuals, that might be a  
23 material weakness that the auditor would identify in the  
24 report.

25 A second way that a company could have a material

J2C5mid3

Bricker - direct

1 weakness would be let's say its company's procedures required  
2 two people to sign the check but that second person didn't show  
3 up and didn't sign the check and so the same person signed two  
4 times but that same person signed two times. That would  
5 essentially be the same person preparing and reviewing the  
6 disbursement. So, in that instance, it would be a material  
7 weakness as well.

8 Q. Do you have an understanding of why the large public  
9 companies are required to have an integrated audit of both  
10 financial statements and the internal controls over financial  
11 reporting or ICFR?

12 A. I do.

13 Q. What's your understanding about that?

14 A. My understanding is that particularly coming through the  
15 early 2000s with sort of a state of corporate misstatements and  
16 corporate issues, Congress issued the Sarbanes-Oxley act and  
17 included within the Sarbanes-Oxley is act a provision that  
18 requires the largest of companies to not only have an effective  
19 system of internal control but also to have auditors check that  
20 system so that investors have a source of insight and greater  
21 confidence regarding the way financial statements are prepared  
22 and then issued to the general public.

23 MR. BOXER: Objection. Move to strike everything, at  
24 least the first half of the answer, as non-responsive and is  
25 narrative.



J2C5mid3

Bricker - direct

1 MS. KRAMER: Your Honor, it is a relevant response to  
2 the question that is relevant to the issues in the trial.

3 THE COURT: The objection is overruled.

4 Next question.

5 BY MS. KRAMER:

6 Q. So, let's talk about a little bit more about the nuts and  
7 bolts of audits. So, you testified about a public company's  
8 financial statements for the year being audited. When you did  
9 that were you talking about the calendar year from January  
10 through December? Or something else?

11 A. So, a year for financial reporting could be a calendar year  
12 but it wouldn't necessarily need to be. It is generally  
13 referring to a 12-month period. Some companies count that  
14 12-month period starting January and ending in December. Other  
15 companies count that 12-month period starting, for example, in  
16 June or starting in July and ending in June.

17 Q. What is the year called that is reflected by that one-year  
18 period in financial statements?

19 A. It's referred to as a fiscal year.

20 Q. When must a public company file its financial statements  
21 with the SEC when its fiscal year end is December 31st, just  
22 the last day of the calendar year?

23 A. For the largest of companies it has 60 days to file its  
24 annual report including its financial statements with the SEC.  
25 Smaller companies have a little bit more time, for example 75

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Bricker - direct

1 days. So, there is a different time frame, depending on the  
2 size of a company. Larger companies have less time, smaller  
3 companies have a little bit more time.

4 Q. So, for a large company with a December 31st fiscal year  
5 end, when is the financial statement filed?

6 A. Generally by the end of February. So, if the calendar  
7 year-end company has ended December 31st, those reports are  
8 generally due February 28. Sometimes it is March 1st,  
9 sometimes it is a leap year.

10 Q. Did you say sometimes there is a leap year?

11 A. Right.

12 Q. Go ahead.

13 A. So, accountants tend to count the 60 days very precisely,  
14 but the rough way to come up with that is at the end of  
15 February, reports are due.

16 Q. Is there a term for the date on which a public company  
17 files its annual financial statements?

18 A. So that's referred to as the filing date.

19 Q. And on that filing date -- withdrawn.

20 When is the auditor's report that contains the opinion  
21 or opinions filed with the SEC?

22 A. The audit report would be filed on the same day, it would  
23 be included in that annual report.

24 Q. Did you say the audit report would be filed the same day?

25 A. That's correct.

J2C5mid3

Bricker - direct

1 Q. So, as an example, just using February 28th as an example,  
2 what is your understanding if that is the filing date, of when  
3 all the audit procedures have to be completed by the auditor?

4 A. All of the audit procedures would need to be completed by  
5 the filing date. So, in other words, all of the audit work  
6 needs to be done whenever the audit report is issued and  
7 available to the general public.

8 Q. I'm sorry. I didn't hear the last part of that. Is  
9 available to the?

10 A. General public.

11 Q. I don't think the microphone is quite long enough for you  
12 but maybe you can move it closer. Thank you.

13 Are you familiar with the term "audit file?"

14 A. I am.

15 Q. What is that?

16 A. An audit file refers to, essentially, just the auditor's  
17 collection of work, generally referred to as an audit file. It  
18 is the body of audit work.

19 Q. What is an audit work paper?

20 A. An audit work paper is an individual piece of work that the  
21 auditor has done as part of the audit. It might be a memo, it  
22 might be a list of numbers that's been added up or checked for  
23 accuracy, but it represents an individual piece of work that  
24 the auditor has done.

25 Q. After the financials are filed with the auditor's report,

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Bricker - direct

1 with those opinions on the filing date, relative to that point  
2 in time, when do the audit work papers all have to be finished?

3 A. So, all of the audit work papers need to be -- well, all of  
4 the work needs to be done when the audit report is issued and  
5 then there is a period of time to sort of collect everything  
6 together and assemble it into an audit file and that's a 45-day  
7 period that auditors have to sort of pull everything together.

8 Q. Is there a name for that 45-day period that people use?

9 A. People generally describe that as the housekeeping period,  
10 again referring to that process of collecting all of the memos,  
11 collecting all of the individual work papers, putting it all  
12 together into an audit file that can be accessible. That audit  
13 file might be electronic, it might be hard copy and so it needs  
14 to be assembled.

15 Q. Have you heard the term "documentation period?"

16 A. Yes.

17 Q. What does that mean?

18 A. Documentation period is another term for that same 45-day  
19 period.

20 Q. Where does that 45-day period come from? What authority  
21 set the 45-day period?

22 A. The 45-day period comes from a PCAOB standard. The PCAOB  
23 is the Public Company Accounting Oversight Board which sets  
24 rules and standards including for that topic.

25 Q. We will turn back to that subject in a little bit but

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Bricker - direct

1 focusing on the 45-day documentation period, to be clear, when  
2 does that start?

3 A. So, that starts when the audit report has been issued so  
4 that was the filing date that we talked about.

5 Q. So, that starts when the financials are files with the  
6 auditor's opinions?

7 A. Right.

8 Q. During that 45-day period, is an auditor generally  
9 permitted to conduct or perform new audit procedures?

10 A. Generally not, unless the auditor has subsequently  
11 discovered some fact that results in a conclusion that the  
12 audit report wasn't properly supported when it was filed.

13 Q. And if the auditor reaches that conclusion in those  
14 exceptions, are there any requirements about what must happen?

15 A. In that case the auditor would need to specifically  
16 identify that circumstance, identify what the circumstance is,  
17 what the additional audit work has been, what the corresponding  
18 conclusions are relative to that work.

19 Q. And is there any requirement of record keeping in that  
20 circumstance?

21 A. There is a documentation requirement. That is that all of  
22 that work be identified and documented specifically.

23 Q. Which are the largest firms that audit public companies in  
24 the United States?

25 A. The largest audit firms are KPMG, Ernst & Young, Deloitte,

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Bricker - direct

1 and PricewaterhouseCoopers which is abbreviated as PWC.

2 Q. Are those also known as The Big Four?

3 A. Yes.

4 Q. Does the SEC regulate auditors of public companies like  
5 those Big Four accounting firms you just mentioned?

6 A. Yes.

7 Q. Does the SEC regulate employees of those Big Four  
8 accounting firms?

9 A. Yes.

10 Q. Generally, what is your understanding of where that  
11 regulatory authority comes from?

12 A. That, my understanding is that regulatory authority comes  
13 from the federal securities laws which have a fairly broad  
14 reach and includes the activities of accountants, and then the  
15 SEC has done rules to further explain what that means.

16 MS. KRAMER: Your Honor, I note that it is two minutes  
17 before 1:00. Is this a logical stopping point for lunch?

18 THE COURT: Yes. Why don't we stop for lunch now.

19 Folks, we will break from 1:00 to 2:00 for lunch. I  
20 am going to remind you that you are not yet discussing the  
21 case.

22 I think Mr. Hampton gave you some information about  
23 where you can go and how you can get in and out of the court  
24 house for lunch. I would like you to be back five minutes  
25 before 2:00 so we can start promptly at 2:00 and continue

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Bricker - direct

1 promptly with the testimony. Please, leave your note pads on  
2 your chairs and have a good lunch.

3 We will see you in an hour.

4 (Continued on next page)

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J2C5mid3

Bricker - direct

1 (Jury not present)

2 THE COURT: You may be seated.

3 MS. KRAMER: Your Honor, may the witness be excused?

4 THE COURT: Yes. You may step down.

5 (Witness steps down)

6 THE COURT: Did anybody want to address anything?

7 MR. WEDDLE: Can we address two items very briefly,  
8 your Honor?

9 THE COURT: Yes.

10 MR. WEDDLE: I am not exactly sure what Mr. Bricker is  
11 going to testify about but as your Honor knows from the  
12 indictment, Mr. Wada's involvement that is alleged, I think I  
13 can say this freely in front of Mr. Bricker, I am comfortable  
14 doing that. As alleged, Mr. Wada's involvement comes at a  
15 certain point in time. I believe that Mr. Bricker had dealings  
16 with other people at KPMG that predate that point in time. So,  
17 if he is having, if is he relating conversations, let's say,  
18 with Mr. Middendorf, if they're being offered for their truth,  
19 they might have a different basis for coming into evidence with  
20 respect to Mr. Middendorf and would not be admissible as  
21 against Mr. Wada. It may not come up, they may not be offered  
22 for their truth, but I don't want to be popping up and  
23 interrupting so I wondered if I could alert your Honor to it  
24 and at an appropriate time, I don't think it is a  
25 question-by-question type of thing, but we could have a



J2C5mid3

Bricker - direct

1 limiting instruction at some point that says certain statements  
2 by Mr. Middendorf were admitted in evidence, I instruct you  
3 that you have to only consider those with respect to  
4 Mr. Middendorf and not with respect to Mr. Wada. And, we can  
5 craft it to put a year or something on it to satisfy everyone.  
6 But, I just didn't want to interrupt the flow.

7 THE COURT: Okay.

8 MR. WEDDLE: That's the first thing, and Mr. Cook had  
9 something else.

10 MR. COOK: Your Honor, we have been attempting to  
11 serve Brian Sweet with a subpoena. We have been attempting to  
12 serve him since February 7th. It appears to us he is  
13 deliberately evading service. For example, we have had folks  
14 at his hotel room; he refuses to come down and accept the  
15 subpoena. We have served his wife, given a copy to  
16 Mr. Morvillo who was here earlier, his lawyer.

17 We would like to avoid the circumstance where we have  
18 to serve him on the stand for documents and then request an  
19 adjournment for documents. So, we are alerting your Honor to  
20 the issue and ask that he be deemed served and we can notify  
21 Mr. Morvillo of that. We told him today that we intended to  
22 have this conversation and therefore we could get documents in  
23 advance and not interrupt the trial.

24 MS. KRAMER: Your Honor, I have not been in the middle  
25 of these communications but when it was brought to my attention

J2C5mid3

Bricker - direct

1 today that it would be raised to your Honor, I had a brief  
2 conversation with Mr. Morvillo about it and he is not here so I  
3 will relay, in sum, what he said, which was that he has  
4 accepted service, he has the subpoena. He has not spoken with  
5 his client about it because he is on an airplane and that he  
6 will speak with his client --

7 THE COURT: The client is on an airplane?

8 MS. KRAMER: Mr. Sweet is on an airplane and he  
9 believes that they will work something out and they will get  
10 back to Mr. Cook.

11 I don't know what the conversations were so I can only  
12 relay what was relayed to me, but Mr. Sweet is a cooperating  
13 witness who has counsel. I don't know that someone asking him  
14 to come down from his hotel room to a hotel lobby when he is  
15 represented by counsel and refusing to do it, if that's what  
16 happened, is properly characterized as evading service. But,  
17 this is the first we have heard of this was today and I  
18 understand Mr. Morvillo is working it out.

19 So, I think it is at least premature and certainly one  
20 of the parties who is necessary for this conversation isn't  
21 here to address it. Mr. Sweet will not be taking the stand  
22 tomorrow so we have some time, I believe, to address it before  
23 he is on the stand. Even if he took the stand this week I  
24 don't think that he would get to cross until next week.

25 THE COURT: Okay. So it sounds like -- I believe you

J2C5mid3

Bricker - direct

1 represented that Mr. Morvillo understood himself to have  
2 accepted service?

3 MS. KRAMER: I don't want to -- I don't actually want  
4 to overstate.

5 I understand that he spoke with Mr. Cook. I believe  
6 he has a copy of the subpoena and is going to speak with his  
7 client about it.

8 THE COURT: Okay.

9 MS. KRAMER: So I don't know what he is authorized to  
10 do. I don't -- so, no --

11 MR. COOK: He expressly disclaimed acceptance although  
12 he has a copy. None of this would have been an issue but he  
13 refused to accept service at the outset of this.

14 THE COURT: Okay.

15 MR. COOK: If we work this out it will be fine. I  
16 just wanted to alert the Court.

17 THE COURT: Okay. I appreciate it. And I assume you  
18 will be speaking with him and then you can update me perhaps  
19 tomorrow where things stand.

20 MR. COOK: All right.

21 THE COURT: Okay. Have a good lunch.

22 MS. KRAMER: Thank you, your Honor.

23 (Luncheon recess)

24 (Continued on next page)

25

J2CYMID4

Bricker - Direct

## AFTERNOON SESSION

2:10 p.m.

THE COURT: Good afternoon, everyone.

MS. KRAMER: Good afternoon.

THE COURT: Are we ready for the jury?

MS. KRAMER: Yes, your Honor.

(In open court; jurors present)

THE COURT: Please be seated.

Good afternoon, ladies and gentlemen. We're continuing with the testimony.

Ms. Kramer, you may proceed.

MS. KRAMER: Yes, your Honor.

Q. Mr. Bricker, what's your understanding about whether at the federal level any entities other than the SEC have authority to regulate the auditors of public companies?

A. At the federal level, the entity, the Public Company Accounting Oversight Board, has authority to regulate auditors.

Q. Is that known as the PCAOB or the Board?

A. It is.

Q. Approximately when was the PCAOB formed?

A. Approximately in 2003.

Q. How was it formed?

A. It was formed by an act of Congress.

Q. What's the name of that act of Congress?

A. It is the Sarbanes-Oxley Act of 2002.

J2CYMID4

Bricker - Direct

1 Q. Are you familiar with the Sarbanes-Oxley Act of 2003?

2 A. I am.

3 Q. I'd like you to take a look at your screen.

4 And we'll just show the witness, Court, and counsel  
5 what's been marked as Government Exhibit 355.

6 Do you recognize this exhibit?

7 A. I do.

8 Q. How do you recognize it?

9 A. I recognize it as a copy of the Sarbanes-Oxley Act of 2003.

10 Q. Is this a public statute?

11 A. It is.

12 Q. Or public act?

13 A. It is.

14 MS. KRAMER: Your Honor, the government offers  
15 Government Exhibit 355.

16 THE COURT: Any objection?

17 MR. BOXER: 4no, your Honor.

18 MR. WEDDLE: No, your Honor.

19 THE COURT: Government Exhibit 355 is received.

20 (Government's Exhibit 355 received in evidence)

21 BY MS. KRAMER:

22 Q. Let's look at page 1.

23 Mr. Bricker, could you please read the subtitle  
24 starting with the words: "An act."

25 A. "An act to protect investors by improving the accuracy and

J2CYMID4

Bricker - Direct

1 reliability of corporate disclosures made pursuant to the  
2 securities laws and for other purposes."

3 Q. All right. Now, if you could turn to Section 101, which is  
4 on page 6.

5 Generally, what does this section provide?

6 A. Generally, Section 101 provides for the establishment of  
7 the Board or the PCAOB, as well as some administrative  
8 provisions relating to that.

9 MS. KRAMER: Mr. Urbanczyk, could you actually  
10 highlight the title that's above the Section 101 heading.

11 Q. So Title 1, what is that called?

12 A. Title 1 is called the Public Company Accounting Oversight  
13 Board.

14 Q. Let's turn to Section 101(a) on page 6.

15 What does the first part of this section say about the  
16 purpose of the Public Company Accounting Oversight Board?

17 A. So it says there it's is established the Public Company  
18 Accounting Oversight Board. And then it goes into its purpose,  
19 "To oversee the audit of public companies that are subject to  
20 the securities laws and related matters in order to protect the  
21 interests of the investors and further the public interest in  
22 the preparation of the informative, accurate, and independent  
23 audit reports for companies, the securities of which are sold  
24 to and held to by public investors."

25 MS. KRAMER: Thank you, Mr. Urbanczyk.

J2CYMID4

Bricker - Direct

1 Q. To be clear, is the PCAOB a government agency or some other  
2 kind of entity?

3 A. The PCAOB is some other type of entity. It's a  
4 not-for-profit corporation.

5 Q. Did you say it's a not-for-profit corporation?

6 A. That is correct. It operates as a not-for-profit  
7 corporation.

8 Q. And what is the composition of the Board?

9 A. The composition of the Board is five individuals referred  
10 to as board members, and then the Board has a chair of the  
11 Board.

12 Q. So throughout the Sarbanes-Oxley Act -- withdrawn.

13 Let's turn to Section 101(c) starting on page 6.

14 What does Section 101(c) provide generally?

15 A. Generally, 101(c) sets forth the duties of the Board.

16 Q. What are the duties of the Board?

17 A. The duties of the Board, as described in 101(c), is to  
18 register public accounting firms, to establish rules generally  
19 speaking for how they prepare audit reports.

20 The third part is to conduct inspections of those  
21 firms, also to conduct investigations and disciplinary  
22 proceedings concerning those firms.

23 Next it's to perform duties or functions that the  
24 Board or the Commission determines are necessary or  
25 appropriate. Next is to enforce compliance with the

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Bricker - Direct

1 Sarbanes-Oxley Act, as well as the rules of the Board,  
2 professional standards, and the securities laws.

3 And then next is to set a budget and to manage the  
4 operations, essentially to have the resources needed to  
5 accomplish all of those purposes.

6 Q. Take a look at Section 107 on page 21.

7 What does Section 107 provide?

8 A. Section 107 provides for the Commission oversight of the  
9 Board. In that context, it's the SEC's oversight of the Board.

10 Q. Okay. So the Commission is the Securities and Exchange  
11 Commission, the SEC?

12 A. That's correct.

13 Q. So who has oversight authority over the PCAOB?

14 A. The SEC does.

15 Q. Who reviews and approves the PCAOB's budget?

16 A. The SEC does.

17 Q. Who approves members of the PCAOB's Board?

18 A. The SEC does.

19 Q. Who approves PCAOB rules?

20 A. The SEC does.

21 Q. Who decides appeals of decisions made by the PCAOB?

22 A. The SEC does.

23 Q. Do you play a role in the SEC's approval of the PCAOB's  
24 budget?

25 A. I do.



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Bricker - Direct

1 Q. What role do you play in that function?

2 A. I play a role of supervising the work, of evaluating the  
3 PCAOB's request and the support for their request, and then  
4 providing a recommendation to the Commission for final approval  
5 or not of the PCAOB's request.

6 Q. And is the PCAOB inspection program a part of the PCAOB's  
7 budget?

8 A. It is.

9 Q. Could you give us some examples of the specific things you  
10 do to administer the SEC's approval of the PCAOB's budget.

11 A. So examples of things that we do as part of approving the  
12 budget, we meet with personnel at the PCAOB, for example, the  
13 head of their inspections department, the head of their  
14 enforcement department, the head of their standard setting  
15 department. We meet with the chair of the PCAOB, other PCAOB  
16 board members to understand the kinds of resources that they  
17 need in order to fully accomplish the PCAOB's mission.

18 We look at the records that they've prepared  
19 supporting their request. We also look at their strategic plan  
20 and the direction and how they've allocated their resources  
21 among their departments.

22 We also look at the experience of the PCAOB over time.  
23 For example, we incorporate the inspection, the inspection  
24 results, the inspection reports and our review of that  
25 information. We consult with others within the SEC in

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1 ultimately bringing that together into a recommendation to the  
2 Commission.

3 Q. In general terms, how much of the PCAOB's budget is  
4 typically consumed by the inspection program?

5 A. In general terms, that is their largest program. So that's  
6 the majority of their budget.

7 Q. In formulating your recommendation to the Commission  
8 concerning the PCAOB's budget, do you rely at all on PCAOB  
9 inspection reports?

10 A. Yes.

11 Q. How?

12 A. We rely on inspection reports to have an understanding of  
13 how auditors are performing their work. For example, it's a  
14 source of information to assess whether there needs to be more  
15 resources for setting new standards.

16 If auditors are not able to follow or comply with the  
17 existing standards, perhaps there's a standards issue and you  
18 need additional standards or rules. So we gather insight from  
19 that.

20 We also gather insight regarding whether the  
21 discipline or enforcement function needs more work. So those  
22 are just examples of the kinds of insights that we take from  
23 inspection reports.

24 Q. Do you play any role in the SEC's approval of PCAOB board  
25 members?

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1 A. I do.

2 Q. What role do you play in that process?

3 A. I play a role of administering the search for candidates to  
4 be appointed to the PCAOB. And the way we do that is through  
5 an open, public announcement of positions.

6 And then I also play a role in reviewing the  
7 candidate's materials -- their resumes, their background  
8 information. And then my office oversees the process of  
9 conducting background checks and so forth and then ultimately  
10 administering the process of Commission approval for the  
11 selection and appointment of new board members.

12 Q. Do you utilize PCAOB inspection reports in your evaluation  
13 of prospective PCAOB board members?

14 A. We do in this way, that if a CPA or someone who has  
15 previously conducted audits that were subject to inspection, we  
16 would take into account -- and we do take into account -- their  
17 performance as an auditor; that is, if the inspection found  
18 sort of issues with that individual's work, then we would take  
19 that into account, and we do take that into account.

20 Q. Do you play any part in the SEC approval of PCAOB rules?

21 A. I do.

22 Q. What role do you play in that process?

23 A. In that process -- so that process starts with the PCAOB  
24 essentially developing a rule, and then in order for the rule  
25 to become effective, it has to be submitted to the SEC.

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1           And when it's submitted to the SEC, it comes to my  
2 office. I then have delegated authority from the Commission to  
3 put that out for public comment which means we take their rule,  
4 we put it on our website, and it's published, and we request  
5 the public to provide input regarding that rule for a period of  
6 time.

7           We then take all of that input, we summarize it, and  
8 provide a recommendation to the commissioners in terms of  
9 whether to approve or disapprove the PCAOB's rule.

10       Q. Do PCAOB inspection reports play any role in the function  
11 you've just described?

12       A. They do. PCAOB inspection reports provide insight into  
13 where or how auditors are performing and areas where PCAOB  
14 rules might need to be adjusted in some way. And so that's the  
15 primary connection for using PCAOB inspection reports in the  
16 rule-making activity.

17       Q. Do you play any role in the SEC's review of comments that  
18 are given in PCAOB reports?

19       A. Yes.

20       Q. What role do you play in that process?

21       A. The role I play in that process is that when the PCAOB  
22 provides an inspection report to an accounting firm, the  
23 accounting firm has the right to seek a review by the SEC, and  
24 that request is made to my office.

25           And so working again under delegated authority, the

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1 request comes in, we look at the reasons and the rationale for  
2 the firm seeking a review, we look at the PCAOB's reasons and  
3 rationale for having a comment, and then we make a judgment  
4 about whether to grant it or not.

5 Q. And do PCAOB inspection reports play a part in that  
6 process?

7 A. Yes. The inspection report is the starting point for that  
8 process.

9 Q. Are the four largest accounting firms like KPMG required to  
10 register with the PCAOB to your knowledge?

11 A. They are required to register.

12 Q. What is the consequence of an accounting firm not being  
13 registered with the PCAOB? Let me withdraw that question and  
14 ask it without so many stops in the middle.

15 What is the consequence of an accounting firm not  
16 being registered with the PCAOB?

17 A. The consequence of not being registered is that the firm  
18 will not be eligible to issue audit reports for inclusion in  
19 those public company filings. So you have to be registered in  
20 order to issue the audit report.

21 Q. Are you familiar with the grounds that exist or some of the  
22 grounds that exist for deregistration with the PCAOB, in other  
23 words, the PCAOB canceling a firm's or an auditor's  
24 registration?

25 A. Yes.

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1 Q. What are some of the grounds for deregistration that you're  
2 aware of?

3 A. Some of the grounds, as a general matter, would be the  
4 audit firm's performance in conducting audits and the  
5 compliance with the PCAOB rules, the SEC's rules, and so forth.  
6 So it's a compliance record.

7 Q. Let's take a look at Section 104 of Government Exhibit 355,  
8 the Sarbanes-Oxley Act on page 13 entitled Inspections of  
9 Registered Public Accounting Firms.

10 What does 104(a) say, Mr. Bricker?

11 A. 104(a), in general terms, says that the Board shall  
12 conduct, is required to conduct, a continuing program of  
13 inspections to assess the degree of compliance that each of the  
14 registered firms, as well as its people or its associated  
15 persons. So the degree of compliance with the Sarbanes-Oxley  
16 Act, the rules of the PCAOB, the rules of the Commission, or  
17 professional standards in the course of conducting audits.

18 Q. Are you familiar with the PCAOB's ethics code?

19 A. I am.

20 Q. Do you know whether or not the PCAOB's ethics code is part  
21 of the PCAOB rules?

22 A. The ethics code is part of the rules of the Board.

23 Q. And looking at 104(a), what's your understanding of what it  
24 means by the term "professional standards"?

25 MR. WEDDLE: Objection, your Honor.

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1 THE COURT: Do you have an understanding of that?

2 THE WITNESS: I do.

3 THE COURT: You can answer.

4 THE WITNESS: The term "professional standards" refers  
5 to the accounting profession's or the audit profession's  
6 standards that are used to guide auditing, as well as the basis  
7 for disciplinary actions, whenever an accountant engages in  
8 improper professional conduct. So those standards are a way of  
9 judging whether someone, an accountant, acted in a proper or  
10 improper way in terms of their conduct.

11 BY MS. KRAMER:

12 Q. Do you have an understanding of the different categories of  
13 conduct negotiated by professional standards?

14 A. So different categories of professional standards would  
15 govern the ethics requirements for accountants who are engaged  
16 in audit activities. It would also govern the performance of  
17 that work, the reporting of that work, or the reporting of the  
18 audit work. So those are just examples of the kinds of conduct  
19 or topic that's covered.

20 Q. If you look at the upper right-hand corner of the box  
21 that's popped up, do you see where it says 15 U.C.S. 7214?

22 A. I do.

23 Q. What's your understanding of what that number means or  
24 corresponds to?

25 A. So that's a cross-reference to where Section 104 has been

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1 incorporated into the United States Code.

2 Q. Are you familiar with Title 15, U.S. Code, Section 7214?

3 A. I am.

4 Q. Please take a look at what's marked for identification as  
5 Government Exhibit 356 which we'll just show to the witness,  
6 Court, and counsel.

7 Do you recognize this exhibit, Mr. Bricker?

8 Mr. Urbanczyk, if you want to scroll through. Thank  
9 you.

10 Do you recognize this exhibit, Mr. Bricker?

11 A. I do. Yes.

12 Q. How do you recognize it?

13 A. It is a copy of the United States Code as annotated.

14 Q. What section?

15 A. Section 7214.

16 MS. KRAMER: The government offers Government Exhibit  
17 356.

18 MR. BOXER: No objection.

19 THE COURT: Received.

20 (Government's Exhibit 356 received in evidence)

21 BY MS. KRAMER:

22 Q. So let's look at page 2 and focus in on subsection C.

23 Under the language: "The Board shall in each  
24 inspection under this section and in accordance with its rules  
25 for such inspections," what are the three things that the Board



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1 is required to do?

2 A. Three things: First is to identify, next is to report, and  
3 third is to begin an investigation.

4 Q. And what is the PCAOB required to do in an inspection with  
5 respect to identifying something? What is the PCAOB required  
6 to identify?

7 A. The identification that the PCAOB is required to do is  
8 identifying any act or practice or omission or failure to act  
9 by a firm or its associated persons that may be in violation of  
10 the Act, referring to the Sarbanes-Oxley Act, or the rules of  
11 the PCAOB or the rules of the SEC or the firm's own quality  
12 control policies or professional standards. So it's  
13 identification of any act or practice or omission relative to  
14 all those things.

15 Q. And in Section 2, who is the Board required to report any  
16 such act, practice, or omission to, if appropriate?

17 A. The reporting is to the Commission and to each appropriate  
18 state regulatory authority as appropriate.

19 Q. Is there a specific way the PCAOB has to fulfill its  
20 reporting requirement under subsection (c)(2)?

21 A. There is no specific way. There are a variety of ways that  
22 that reporting could occur.

23 Q. What are some of those ways?

24 A. The PCAOB could report just directly in a direct meeting or  
25 direct conversation. The PCAOB could report in an inspection

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1 report. The PCAOB could also report in sort of a very specific  
2 reporting type that it's developed referred to as a 4004  
3 report. That's a specific type of report. Those are just  
4 examples of the ways that reporting could occur.

5 Q. What is a 4004 report?

6 A. A 4004 report is a particular type of report that the PCAOB  
7 has developed itself to identify a possible area of  
8 noncompliance. And it might be an accounting issue that  
9 they've identified in an inspection, it might be a possible  
10 failure of the auditor to be independent, or it might be some  
11 other act or conduct. But that's just a type of report that  
12 the PCAOB has developed.

13 Q. In your experience, does the PCAOB typically transmit 4004  
14 reports to the SEC on matters that the PCAOB has already told  
15 the SEC about?

16 MR. BOXER: Objection.

17 THE COURT: You can answer. Overruled.

18 THE WITNESS: I'm sorry. I've forgotten the question.

19 BY MS. KRAMER:

20 Q. That's okay.

21 In your experience, does the PCAOB typically transmit  
22 4004 reports to the SEC on matters that the PCAOB has already  
23 told the SEC about?

24 A. No. Because 4004 reports is just one way of reporting. If  
25 an issue has been communicated through some other means, they

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1 may forego duplication in reporting.

2 Q. Let's take a look at subsection D. It starts on page 2,  
3 and it goes on to page 3.

4 What are the objectives of an inspection that are set  
5 forth here in subsection D?

6 A. The objectives of the inspection is to inspect and review  
7 the firm's audit engagements, as well as their review  
8 engagements that have been performed throughout the firm's  
9 various offices and by its various personnel, its associated  
10 persons, and to do that on the basis of engagements that have  
11 been selected by the Board. So that's its first objective.

12 Then its second objective is to evaluate the  
13 sufficiency of the firm's quality control system, as well as  
14 the manner of the firm's documentation, how it's communicated  
15 that system.

16 And then last, to perform such other testing of the  
17 firm's procedures -- they might be audit procedures,  
18 supervisory procedures, its quality control procedures -- that  
19 are necessary and appropriate in order to accomplish the  
20 inspection and responsibilities of the Board.

21 Q. All right. Let's spend a moment on what is meant by the  
22 quality control system of the firm.

23 In general terms, what does that mean?

24 A. In very general terms, a quality control system is  
25 essentially the way a firm ensures consistency in the quality

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1 of its audit services. So, for example, it might be having  
2 policies for recruiting the right kinds of accountants and  
3 auditors, making sure they have the right information.

4 It might also be having the right tools for an auditor  
5 to do his or her work, the right techniques, the right  
6 training, the right policies. And it might also be the firm's  
7 sort of tone and their incentives; that is, how management of  
8 the firm reinforces its own expectation about what's important  
9 to the firm and to the auditors and accountants who work on the  
10 engagements. So those are just examples of a quality control  
11 system of the firm.

12 Q. Does an auditor's quality control system matter to the SEC?

13 A. It does.

14 Q. Why does it matter to the SEC?

15 A. It matters to the SEC because the SEC is placing reliance  
16 on the work of auditors in looking at and conducting audits of  
17 all of the public companies within our jurisdiction.

18 So we're placing reliance on the firms, and one way  
19 that we are satisfied about the performance of the quality of  
20 those audit services is through the quality control systems  
21 that firms have.

22 Q. When you talk about the quality of an audit, are you just  
23 talking about the auditor's evaluation of the numbers in the  
24 financial statement?

25 A. It includes that, but it's broader. A quality audit is one

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1 in which the auditor has an appropriately -- has an appropriate  
2 state of mind; that is, they're objective. They're impartial.  
3 They make judgments that are consistent with professional  
4 standards. Their conduct is consistent with professional  
5 standards.

6 And that that is really the foundation and the  
7 starting point for then checking the numbers. So an auditor  
8 has to be professional with good due care, good skepticism in  
9 the course of performing the work so that judgments and  
10 problems within the financial statements are identified and  
11 resolved.

12 Q. Let's take a look at Section G on page 3.

13 What is Section G about?

14 A. Section G is about reporting, more specifically about the  
15 PCAOB's reporting of the results of inspections.

16 Q. So let's look at what does subsection G(1) say? So the  
17 language under G and then unto subsection 1.

18 A. It says that: "A written report of the findings of the  
19 Board for each inspection" under this section of law "shall be  
20 transmitted in appropriate detail to the Commission," the SEC  
21 "and to each appropriate state regulatory authority accompanied  
22 by any letter or comments by the Board or the inspector and any  
23 letter of response from the registered public accounting firm."

24 Q. What's your understanding of why the PCAOB inspection  
25 reports are required to be transmitted to the SEC?

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1 MR. BOXER: Objection.

2 THE COURT: Overruled.

3 You can answer.

4 THE WITNESS: The reports are required to be  
5 transmitted because the PCAOB inspection is an inspection that  
6 evaluates compliance with, among other things, the SEC's rules.  
7 And so that's necessary information for the SEC to have.

8 But it also includes information about compliance with  
9 the PCAOB's rules and other rules so that the Commission has  
10 that information in running the Commission and allocating our  
11 own resources.

12 Q. From your experience at the office of the chief accountant,  
13 as deputy chief accountant and now chief accountant, are you  
14 familiar with the PCAOB's inspection process?

15 A. I am.

16 Q. Are you familiar with the reports that are issued at the  
17 end of that process?

18 A. I am.

19 Q. How frequently are inspection reports issued by the PCAOB  
20 for its inspection of the Big 4 accounting firms?

21 A. They're required to be inspected annually and then reported  
22 on following those inspections. So roughly every year.

23 Q. What's your understanding about how the inspection process  
24 starts for the large accounting firms like KPMG?

25 MR. BOXER: Objection. Foundation.

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1 THE COURT: Sustained.

2 Establish foundation, please.

3 MS. KRAMER: Certainly.

4 Q. You testified a moment ago that you're familiar with the  
5 PCAOB inspection process through your time in the Office of the  
6 Chief Accountant.

7 How are you familiar with the PCAOB inspection  
8 process?

9 A. I'm familiar with the inspection process by interacting  
10 with the PCAOB, including through the budget procedures, being  
11 familiar with the Sarbanes-Oxley Act, and being familiar with  
12 the rules of the PCAOB.

13 Q. Is part of your job overseeing the PCAOB?

14 A. Yes.

15 Q. Is understanding the PCAOB inspection process a part of you  
16 performing your job?

17 A. Yes.

18 MS. KRAMER: May I proceed, your Honor?

19 THE COURT: Yes.

20 BY MS. KRAMER:

21 Q. So what's your understanding about how the inspection  
22 process begins for large accounting firms like KPMG?

23 A. The inspection process really starts with firms updating  
24 their registration information with the PCAOB by providing  
25 information about all of the individual audits that it's done

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1 or plans to do for a given period of time.

2 And then the PCAOB has that information, that is, the  
3 listing of audits that will be done, along with information  
4 about those audits, the engagement partner, the size of the  
5 audit. Those are just examples. That's where they start.  
6 They start with that list of engagements.

7 Q. A couple follow-up questions.

8 What's an engagement partner?

9 A. An engagement partner is the individual who leads the work  
10 for the audit firm for a particular audit.

11 Q. Do you know how that list of audits is provided from the  
12 firm to the PCAOB? Is it electronically provided? Is it on  
13 paper? Do you know?

14 A. It's generally provided electronically.

15 Q. To put it in context, approximately how many audits of  
16 public companies do the large accounting firms perform each  
17 year and then report to the PCAOB?

18 A. It varies according to firm. So it may be, you know,  
19 approximately 700. It might be 1,000, sort of in that general  
20 range. It varies according to firm and year to year.

21 Q. And as part of the PCAOB's inspection of one of the large  
22 accounting firms, approximately how many of those 700 or so  
23 audits does the PCAOB specifically inspect each year?

24 A. It varies year to year but approximately 50.

25 Q. Do you have an understanding of the phases of the PCAOB



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1 inspection process with respect to each audit?

2 A. Yes.

3 Q. So after the PCAOB has gathered the list of audits for an  
4 accounting firm for a year, what is your understanding of the  
5 next step that the PCAOB takes?

6 A. The next step that the PCAOB would take is to receive that,  
7 evaluate the list, evaluate specific areas of risk, the risk  
8 that audits might not have been done in a compliant way. And  
9 then the PCAOB would select specific audits for further  
10 inspection by the inspections group.

11 Q. What's your understanding about when the PCAOB gives an  
12 accounting firm like KPMG notice about when the PCAOB is going  
13 to inspect a specific audit?

14 MR. BOXER: Objection.

15 THE COURT: Overruled.

16 You can answer.

17 THE WITNESS: The PCAOB provides notice, generally  
18 speaking, to the firm after the audit has been completed and  
19 with just enough time for the audit firm to gather together its  
20 audit file, its records to make sure that the auditors who were  
21 assigned to that engagement are available to meet with the  
22 inspectors. So that might be two or three weeks before the  
23 PCAOB actually visits the audit firm's office and does an  
24 inspection of the audit work.

25 BY MS. KRAMER:

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1 Q. And what's your understanding about when the PCAOB gives  
2 that notice relative to the end of that 45-day documentation  
3 period?

4 A. Generally speaking, it's after the 45-day period so that  
5 the audit file has been assembled, has been pulled together,  
6 and preserved or, said another way, archived.

7 Q. Do you have an understanding of why notice is generally not  
8 given by the PCAOB before the work papers are archived?

9 MR. BOXER: Objection.

10 MR. WEDDLE: Objection, your Honor.

11 THE COURT: Overruled.

12 THE WITNESS: Notice is not given earlier because the  
13 PCAOB is only looking at say the 50 of a firm's total listing  
14 of audit engagements. And so what the PCAOB is essentially  
15 spot checking all of the -- spot checking a few in order to  
16 reach conclusions about the firm's quality of audit services  
17 and their quality controls for the entire firm. And so earlier  
18 notice, if given, would --

19 MR. BOXER: Objection, your Honor. It's a narrative.

20 MR. WEDDLE: Objection.

21 THE COURT: Sustained.

22 You can ask another question.

23 MS. KRAMER: Certainly, your Honor.

24 Q. Does it matter to the SEC as a user of the inspection  
25 reports that notice is not given before the audit work papers

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1 are archived?

2 A. Yes.

3 Q. Why does that matter to the SEC?

4 A. It matters to the SEC because we're counting on the PCAOB's  
5 inspection program to be operating in the way that it's been  
6 designed to operate. And it's been designed to operate on the  
7 basis of using resources to look at a few of the engagements,  
8 not all of the engagements, and then to be able to prepare a  
9 report that's useful on the basis of that inspection work.

10 Q. Does it matter to the SEC as a user of the inspection  
11 reports that the accounting firms comply with the PCAOB  
12 inspection process?

13 A. Yes.

14 Q. Why? Why does that matter to the SEC?

15 A. It matters to the SEC because the SEC is counting on the  
16 work of audit firms, and we're counting on the PCAOB's work to  
17 give us insight about the quality of audit services that the  
18 SEC is counting on.

19 Q. How, if at all, does an auditor's degree of compliance with  
20 the PCAOB inspection process inform you about the quality of  
21 that auditor?

22 A. I'm sorry. Could you repeat the question.

23 Q. Sure. I think you testified that the inspection process  
24 gives you information about the quality of the auditor.

25 How is that?

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1 A. The inspection process gives us insight into the quality  
2 through the inspection reports, as well as through our meetings  
3 with the PCAOB.

4 Q. Does the integrity of auditors matter to the SEC?

5 A. Yes.

6 Q. Why?

7 A. The integrity of auditors matters to us because we're  
8 counting on auditors to do good work and to check the financial  
9 statements that management has prepared. And so our ability to  
10 place reliance on accountants as gatekeepers to the  
11 information, to the financial information that is making its  
12 way to the marketplace, is at least, in part, grounded on the  
13 integrity of the individuals who are serving as accountants and  
14 auditors.

15 Q. When the PCAOB makes its inspection selections, when it  
16 chooses which specific audits it's going to inspect in a year,  
17 does the PCAOB tell the SEC, to your knowledge, of those  
18 selections?

19 A. No.

20 Q. When does the SEC find out about which audits were selected  
21 for inspection by the PCAOB?

22 A. Generally speaking, we find out whenever the PCAOB has  
23 issued its inspection report.

24 Q. And when does that inspection report get issued relative to  
25 when the inspections happen?

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1 A. The inspection report is the end of the process. So the  
2 report is developed after the PCAOB has made the selections,  
3 they've conducted the inspections, then they've written the  
4 report. That's the point at which we, generally speaking, find  
5 out.

6 Q. When does the SEC receive the PCAOB's inspection report  
7 relative to when it is publicly issued and the public gets it?

8 A. At the same time.

9 Q. So the PCAOB does not share with the SEC its list of which  
10 audits it's going to inspect?

11 MR. BOXER: Objection. Asked and answered.

12 MR. WEDDLE: Objection, your Honor.

13 THE COURT: Overruled. You can answer.

14 THE WITNESS: No.

15 BY MS. KRAMER:

16 Q. Does the SEC play any role, to your knowledge, in training  
17 PCAOB inspectors?

18 A. Yes. We participate in the training for PCAOB inspectors.

19 Q. Do you know if the Office of the Chief Accountant that you  
20 had participate in the training of PCAOB inspectors?

21 A. Yes. Both the office and myself personally.

22 Q. And do you know whether any other offices or divisions  
23 within the SEC participate in the training of PCAOB inspectors?

24 A. Yes, they do.

25 Q. Which ones are you aware of?

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1 A. The Division of Corporation Finance is one. There may be  
2 others, but that's one of the significant ones.

3 Q. And typically how long is the session that the Office of  
4 the Chief Accountant conducts in the PCAOB inspector training?

5 A. It's generally for an hour on the very first day of a two-  
6 or three-day training session. And it's designed to be the  
7 first day because it sets sort of the tone for the inspector's  
8 training over the course of their remaining training session.

9 Q. What is OCA typically focused on during these inspector  
10 trainings?

11 A. Generally we focus on the importance of the PCAOB and its  
12 mission and how the PCAOB's mission integrates with the SEC's  
13 work. So we start with why the inspection process is relevant,  
14 why the PCAOB is relevant.

15 And then, generally speaking, we move into technical  
16 topics for accountants and auditors. It might be updates on  
17 SEC rules or updates on accounting standards, updates on our  
18 own processes.

19 Q. Does the SEC regulate auditors of public companies  
20 directly, indirectly, or both?

21 MR. BOXER: Objection. I think it calls for a legal  
22 conclusion, your Honor.

23 THE COURT: He can testify to his understanding.

24 BY MS. KRAMER:

25 Q. Based on your experience as the chief accountant at the

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1 SEC, what's your understanding about whether the SEC regulates  
2 auditors of public companies directly, indirectly, or both?

3 MR. BOXER: Objection.

4 THE COURT: Overruled.

5 THE WITNESS: We regulate both directly as well as  
6 indirectly.

7 BY MS. KRAMER:

8 Q. And to your knowledge, based on your job and your  
9 experience at the SEC, what are some of the offices and  
10 divisions at the SEC that directly regulate auditors of public  
11 companies?

12 A. The Office of the Chief Accountant is one, and we do that  
13 include a particular rule referred to as Rule 102(e). The  
14 Division of Enforcement also regulates directly. And then  
15 other divisions and offices may identify information that's  
16 relevant to the regulation of auditors and accountants more  
17 generally.

18 Q. You mentioned Rule 102(e).

19 What is your understanding of Rule 102(e)?

20 A. Rule 102(e) is a specific rule issued by the SEC which  
21 deals with, among other things, improper professional conduct  
22 by accountants. So it's a source of authority for the SEC to  
23 regulate accountants. It provides a basis for our work in that  
24 area.

25 Q. From your experience and generally your role at the SEC,

J2CYMID4

Bricker - Direct

1 are you familiar with what the Division of Enforcement's  
2 authority is to regulate auditors and accountants?

3 A. The basis of that authority is much more generally the  
4 federal securities laws such as the 1933 Act, the 1934 Act.  
5 Both are sort of long-standing references to the federal  
6 securities laws.

7 Q. And to your knowledge, does the Division of Enforcement  
8 have authority to bring actions for violations of PCAOB rules?

9 A. Yes.

10 Q. Do you know where that authority comes from in your  
11 understanding?

12 A. In my understanding, PCAOB rules, when they go through the  
13 Commission's approval process, are incorporated into the 1934  
14 Act. So the SEC both goes through that process for the PCAOB  
15 and then incorporates those into the federal securities laws.

16 Q. Does the SEC have the authority, to your knowledge, to bar  
17 an accountant from practicing before the SEC?

18 A. Yes.

19 Q. What does it mean for an accountant or auditor to be barred  
20 from practicing before the SEC?

21 A. What that means, in general terms, is that the accountant,  
22 because of that Commission action, is no longer permitted to  
23 appear or practice before the Commission, meaning it couldn't  
24 work on an audit of a public company as just an example.

25 Also it wouldn't be eligible to work for a public



J2CYMID4

Bricker - Direct

1 company in preparing the financial statements; whereas, the  
2 third example, wouldn't be eligible to serve on a corporate  
3 board overseeing the financial reporting process. Those are  
4 just examples.

5 (Continued on next page)

J2C5mid5

Bricker - direct

1 BY MS. KRAMER:

2 Q. Are you familiar with something called the American  
3 institute of CPAs, or the AICPA?

4 A. I am.

5 Q. In your understanding, what is that?

6 A. The American institute of CPAs is an institute whose  
7 members have met the requirements for being licensed as a CPA.  
8 It's a membership body, it has an ethics code, it has a  
9 disciplinary process such that accountants are subject to the  
10 professional standards and ethics codes of the AICPA.

11 Q. Have you ever spoken at an AICPA conference?

12 A. Yes.

13 Q. What was the subject matter of the conference or  
14 conferences you have spoken at?

15 A. Over the years I have spoken at a few of their conferences.  
16 They have a national conference every December, it's a  
17 conference devoted to SEC and PCAOB developments so that CPAs  
18 can be generally informed about the SEC's rules, updates,  
19 expectations, as well as the PCAOB's; and, I have spoken at  
20 that several years.

21 Q. Let's turn to be PCAOB inspection reports. Have you  
22 reviewed PCAOB inspection reports for KPMG?

23 A. Yes.

24 Q. I am showing you, the Court and counsel as well, Government  
25 1. Do you recognize this document?

J2C5mid5

Bricker - direct

1 A. Yes.

2 Q. How do you recognize it?

3 A. I recognize it as the PCAOB's inspection report of KPMG  
4 which was issued October 15th of 2015.

5 MS. KRAMER: Your Honor, the government offers  
6 Government Exhibit 1.

7 MR. BOXER: No objection.

8 MR. WEDDLE: No objection.

9 THE COURT: Government Exhibit 1 is received.

10 (Government's Exhibit 1 received in evidence)

11 BY MS. KRAMER:

12 Q. Let's look at the front page. What is the title of this  
13 report?

14 A. The title is Report on 2014 Inspection of KPMG, LLP, and it  
15 is specifically KPMG headquartered in New York, New York.

16 Q. Where is the date of issuance that you said was October 15,  
17 2015?

18 A. That's correct.

19 Q. Is that in the middle of the page?

20 A. It is.

21 Q. What is your understanding about when the inspections were  
22 conducted that are the subject of this report?

23 A. Largely conducted in 2014. There would have been  
24 activities occurring prior to that and some after that, but  
25 largely during 2014.

J2C5mid5

Bricker - direct

1 Q. Let's start to page 2 of Government Exhibit 1 and I would  
2 like you to look at the first sentence of the second paragraph.  
3 What does that sentence say?

4 A. The first sentence says: Inspections are designed and  
5 performed to provide a basis for assessing the degree of  
6 compliance by a firm with applicable requirements related to  
7 auditing issuers.

8 Q. What do you understand that to mean?

9 A. What that means is that the inspections have been designed  
10 in a particular way consistent with the PCAOB's inspections  
11 program and that they've been performed, again consistent with  
12 the PCAOB's inspections program, and all of that is done to  
13 serve as a basis for the PCAOB's assessment of whether the firm  
14 complied or the degree of its compliance with the applicable  
15 requirements for auditing. It includes the word "issuers"  
16 which is a term that generally refers to public companies, it  
17 is companies that have issued stock.

18 Q. As a user of the inspection reports, is it important to the  
19 SEC that inspections are designed and performed to provide a  
20 basis for assessing the degree of compliance by a firm with  
21 applicable requirements?

22 A. Yes.

23 Q. Why?

24 A. That's important because our, the starting point is the  
25 design -- the PCAOB's design of their inspections program. It

J2C5mid5

Bricker - direct

1 has been designed in a particular way and that design is such  
2 that the PCAOB is able to look at a few of the engagements, not  
3 all of the firm's engagements, to have a basis for the  
4 reporting that it does.

5 Q. What's your understanding of whether the fact that the  
6 PCAOB only notifies a firm of which audits it's going to  
7 inspect, typically after the 45-day documentation period is  
8 over, what's your understanding of whether that is part of the  
9 design that makes the inspections provide a basis for assessing  
10 the degree of compliance by a firm with applicable  
11 requirements?

12 MR. BOXER: Objection.

13 MR. WEDDLE: Objection, your Honor.

14 MS. KRAMER: It was a long question. Would you like  
15 me to ask it again, your Honor?

16 THE COURT: Could you please rephrase it?

17 MS. KRAMER: Certainly, your Honor.

18 BY MS. KRAMER:

19 Q. What is your understanding about whether the timing of the  
20 PCAOB's notice is a part of the design of the inspection that's  
21 referenced in this sentence?

22 MR. WEDDLE: Objection.

23 THE COURT: Overruled.

24 You can answer, if you have an understanding.

25 THE WITNESS: I do have an understanding.

J2C5mid5

Bricker - direct

1           The timing of notice to a firm is an element of the  
2 design of the PCAOB's program.

3 BY MS. KRAMER:

4 Q. In your understanding as a user of the inspection reports,  
5 is it an important part of the design?

6 A. It is --

7 Q. Why?

8 A. -- an important part.

9           It is important because the design of not having  
10 advanced notice, if an audit team had earlier notice then it  
11 might essentially conduct the --

12 MR. BOXER: Objection, your Honor.

13 THE COURT: Overruled.

14 You can explain your understanding.

15 THE WITNESS: My understanding is that advanced notice  
16 would enable not only the team but the firm to focus on just  
17 the few, the 50 or so engagements that the PCAOB would look at  
18 and not all of the engagements. But, the PCAOB is reporting on  
19 the firm's system as a whole and not just those few and so we  
20 are counting on our ability to have a sense for the firm's  
21 degree of compliance, not just limited to those few.

22 BY MS. KRAMER:

23 Q. Let's turn to page 3. What's your understanding of what's  
24 contained in Part I of the inspection report entitled -- well,  
25 what is your understanding of what is contained in Part I of

J2C5mid5

Bricker - direct

1 the inspection report?

2 A. Part 1 of the inspection report describes the inspection  
3 procedures, as well as certain observations that the PCAOB  
4 identified in the course of the inspection procedures.

5 Q. And, if you look at the first paragraph under the heading  
6 Review of Audit Engagements, do you see the second sentence  
7 that begins with: *The inspection team*?

8 A. Yes.

9 Q. What does that say?

10 A. It says: The inspection team identified matters that it  
11 considered to be deficiencies in the performance of the work  
12 that it reviewed.

13 Q. What does a deficiency mean in this context?

14 A. In this context a deficiency is a deficiency in the  
15 compliance of the firm relative to one of the rules, whether it  
16 is PCAOB rules or Commission rules, etc.

17 Q. What is a comment?

18 A. A comment refers to how the inspection team expresses that  
19 deficiency. So, if it's identified something and then it  
20 comments on what it has seen, that's generally referred to as a  
21 comment.

22 Q. What's your understanding of how many deficiencies in an  
23 audit -- I'm sorry, let me withdraw that question.

24 What is your understanding of how many deficiencies in  
25 an inspection make it a failed inspection?

J2C5mid5

Bricker - direct

1 A. It could be one or more. The focus is on whether there is  
2 a deficiency that rises to a level that the audit report was  
3 not sufficiently supported whenever it was issued.

4 Q. So, look at the first sentence in this paragraph. How many  
5 individual audits were inspected by the PCAOB as part of the  
6 PCAOB's inspection of KPMG in 2014?

7 A. So, in this case the PCAOB inspected 51 audits.

8 Q. And let's take a look at page 5 under the heading Effect on  
9 Audit Opinion, the first sentence. How many of the 51 KPMG  
10 audits inspected in 2014 had deficiencies?

11 A. 28 of them did.

12 Q. So, how many of the 51 were considered failed audits?

13 A. 28 of them were.

14 Q. Turning to the bottom of page 6, do you see where it says  
15 issuer A in the heading A.1?

16 A. I do.

17 Q. What is your understanding of what is designated here by  
18 issuer A, in general terms?

19 A. In general terms, the PCAOB uses this type of terminology.  
20 Issuer A, issuer B, C, etc., to refer to a particular public  
21 company, an issuer of stock. So, public company A was the  
22 audit that was inspected, it was the audit of company A which  
23 is designated as issuer A.

24 Q. So this would be, just to illustrate, the Smith company is  
25 replaced or anonymized as issuer A?



J2C5mid5

Bricker - direct

1 A. That's correct.

2 Q. What is your understanding of why the Part I of the PCAOB  
3 inspection report refers to the engagements with the public  
4 companies that were audited as issuer A, issuer B, and doesn't  
5 just include their names?

6 A. It doesn't include the company's name because the PCAOB's  
7 work, its purpose is to look at the audit firm's compliance.  
8 Its purposes is not to evaluate whether the financial  
9 statements of that company were prepared in an appropriate way.

10 So, the use of an anonymous reference here avoids the  
11 public having the misunderstanding that the PCAOB has reached a  
12 judgment about the company's financial statements. Instead,  
13 the PCAOB is focused on the audit firm's work, not the  
14 underlying company's work.

15 Q. Let's turn to page 61. What is in part II of the PCAOB  
16 inspection report of KPMG for 2014? What kind of information  
17 is contained in part II?

18 A. Part II contains a discussion of the PCAOB's criticisms of  
19 and potential defects in the firm's quality control system.

20 Q. Okay. When Part I is publicly released in this case  
21 October 15th, 2015, what is your understanding about whether  
22 Part II was publicly released on that date?

23 A. On that date, Part II was not publicly released.

24 Q. Do you have an understanding, based on your experience, of  
25 the process that is used by the PCAOB with respect to Part II

J2C5mid5

Bricker - direct

1 issuance?

2 A. Yes.

3 Q. So, what happens with Part II in terms of when it is  
4 released to the firm KPMG, the SEC, and the public?

5 A. Part II is released to the firm at the same time as Part I  
6 but Part II remains non-public in order to provide an incentive  
7 for the firm to address those criticisms. And, they have 12  
8 months to address those criticisms to the satisfaction of the  
9 PCAOB. If they've failed to address those criticisms, then the  
10 information in Part II is released to the public. Part II is  
11 released to the SEC at the same time that it is issued to the  
12 firm, that is, we get it, we get the non-public version at the  
13 same time that the firm gets it.

14 Q. So, looking at the date of this report of October 15, 2015,  
15 when did the SEC get Part II?

16 A. October 15th, 2015, roughly speaking.

17 Q. What is the first comment or deficiency that is in the  
18 Part II of the 2014 inspection report for KPMG?

19 A. It's titled Concerns Related to the Tone at the Top.

20 Q. What does that mean?

21 A. That means that the PCAOB inspection team developed  
22 concerns regarding KPMG's tone at the top of the firm regarding  
23 the commitment to and the focus on addressing audit quality or  
24 quality in the audit services, and the PCAOB has expressed that  
25 concern within the report to enable the firm an opportunity to

J2C5mid5

Bricker - direct

1 address it.

2 Q. And what does the last sentence of this paragraph say?

3 A. It says: Continuing improvement in the firm's tone at the  
4 top is important, as it is fundamental to the goal of achieving  
5 significant improvements in audit quality.

6 Q. Do you agree with that?

7 A. I do.

8 Q. Does tone at the top matter to the SEC, a user of the PCAOB  
9 inspection reports?

10 A. It does.

11 Q. Why?

12 A. As I have spoken at conferences about the importance of a  
13 firm's tone at the top, it's vital to the ability of  
14 accountants and auditors who are working at firms to be  
15 well-supported in making the tough calls and the judgments that  
16 are needed in the conduct of an audit of a public company.

17 Q. Let's take a look at page 65, the heading Deficiencies In  
18 Testing the ALL. Could you remind the jury what ALL refers to?

19 A. Sure. ALL refers to the allowance for loan losses. That  
20 was the adjustment in our example of \$10 where the company  
21 didn't expect to fully collect on a loan.

22 Q. And what's your understanding of what it means that  
23 deficiencies in testing the ALL are in Part II of the  
24 inspection report?

25 A. What this is referring to is the PCAOB inspections, the

J2C5mid5

Bricker - direct

1 staff identified deficiencies in the firm's quality of controls  
2 with respect to the way audit teams were testing the allowance  
3 for loan losses in the audits that they identified.

4 Q. So, do you see the second sentence here, the inspection  
5 team reviewed the firm's auditing of the ALL in 12 audits and  
6 identified deficiencies in the testing of the ALL in seven of  
7 these audits?

8 A. Yes.

9 Q. Each of which is included in part 1A of this report.

10 Do you see that?

11 A. Yes.

12 Q. So, is it your understanding that the ALL testing was a  
13 comment or deficiency in seven issuers listed in Part I?

14 A. Yes.

15 Q. What's your understanding about when the Part I comment is  
16 also included in Part II?

17 A. So, a Part I comment is a comment for a specific audit.  
18 It's included in Part II if you see the same thing multiple  
19 times such that it would suggest that there is a broader  
20 systematic issue, something wrong with the underlying process,  
21 underlying methodology, those sorts of things. And so, if you  
22 see the same thing being repeated, then that's the kind of  
23 thing that would be included in Part II and that's what's  
24 reflected in seven of 12 audits. There were concerns in the  
25 testing of the allowance.

J2C5mid5

Bricker - direct

1 MS. KRAMER: Your Honor, I wasn't sure if there was a  
2 problem with a screen in the jury box. Is anyone having a  
3 problem with the screen?

4 THE COURT: Can you all see the screen?

5 JUROR: I just tilted it.

6 THE COURT: You all can see?

7 THE JURY: Yes.

8 THE COURT: Thank you.

9 BY MS. KRAMER:

10 Q. Did you review the 2014 KPMG inspection report that's in  
11 evidence as Government Exhibit 1 in conducting your job at the  
12 SEC?

13 A. Yes.

14 Q. And, did you use this report in fulfilling any of the  
15 functions that you testified about earlier?

16 A. Yes.

17 Q. I would like you to take a look at what's marked for  
18 identification as Government Exhibit 3. Do you recognize this  
19 exhibit?

20 A. Yes.

21 Q. How do you recognize it?

22 A. This is a PCAOB of the inspection of KPMG which was issued  
23 November 9th of 2016, so this is on the 2015 audits.

24 MS. KRAMER: The government offers Government Exhibit  
25 3.

J2C5mid5

Bricker - direct

1 MR. BOXER: No objection.

2 MR. WEDDLE: No objection.

3 THE COURT: Government Exhibit 3 is received.

4 (Government's Exhibit 3 received in evidence)

5 BY MS. KRAMER:

6 Q. Let's look at the front cover. So, what is the title of  
7 this document?

8 A. The title is Report on 2015 inspection of KPMG, LLP, and it  
9 is the one headquartered in New York, New York.

10 Q. What date was this released?

11 A. It was issued by the PCAOB on November 9, 2016.

12 Q. Is that when the SEC received it?

13 A. Yes.

14 Q. Did you review Government Exhibit 3 in performing your  
15 duties at the SEC?

16 A. Yes.

17 Q. Did you use this report in fulfilling any of the functions  
18 you testified about earlier?

19 A. Yes.

20 Q. Did you rely on this report in performing any of those  
21 functions that you testified about earlier?

22 A. Yes.

23 Q. If, when looking at is this, you knew that individuals at  
24 KPMG had secretly obtained advance knowledge of some of the  
25 inspection selections, would that have affected your ability to

J2C5mid5

Bricker - direct

1 rely on this report?

2 MR. BOXER: Objection.

3 MR. WEDDLE: Objection, your Honor.

4 THE COURT: Overruled.

5 THE WITNESS: Yes.

6 BY MS. KRAMER:

7 Q. Why?

8 A. It would have affected my ability to rely on it because  
9 this report would have been prepared on a different basis than  
10 the other reports from the other firms. That is to say, with a  
11 particular understanding of the design of PCAOB's inspection  
12 program, then I incorporate that understanding of their program  
13 into how I read and use and rely on the reports that are  
14 generated by that program. So, if the program really isn't  
15 working as designed for one firm, then that would be important  
16 to know when using this report.

17 Q. And would that be true, would it affect your ability to  
18 rely on the report even if the work papers had already been  
19 archived and couldn't be changed?

20 A. Yes.

21 MR. BOXER: Objection.

22 MR. WEDDLE: Objection.

23 THE COURT: Overruled.

24 THE WITNESS: Yes.

25 BY MS. KRAMER:

J2C5mid5

Bricker - direct

1 Q. Why?

2 A. It would be important because the premise for the selection  
3 of the engagements and the information about just the 50  
4 engagements that the PCAOB looked at wouldn't necessarily be  
5 representative of the firm's total portfolio of engagements  
6 that, audits of public companies that are regulated by the SEC.

7 Q. I would like to show you now what's been marked for  
8 identification as Government Exhibit 5. Do you recognize this  
9 exhibit?

10 A. Yes.

11 Q. How do you recognize it?

12 A. As an inspection report of KPMG.

13 Q. For what year?

14 A. This was the 2016 inspections. It was issued January 15th  
15 of this year, 2019.

16 MS. KRAMER: The government offers Government Exhibit  
17 5.

18 MR. BOXER: May we have a moment, your Honor?

19 THE COURT: Yes.

20 (Counsel conferring)

21 MR. BOXER: Your Honor, can we either approach or  
22 address it at the next break? But there is an issue with this  
23 particular exhibit.

24 THE COURT: You know, normally we take a mid-afternoon  
25 break anyway, why don't we take a 10 minute break.



J2C5mid5

Bricker - direct

1 Ladies and gentlemen, leave your note pads on your  
2 chairs and we will continue in 10 minutes.

3 (Continued on next page)

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J2C5mid5

Bricker - direct

1 (Jury not present)

2 THE COURT: You sir, you may step down.

3 (Witness steps down)

4 THE COURT: Do you want to talk about it now?

5 MS. KRAMER: Your Honor, if we are talking about an  
6 evidentiary issue, can we wait until the witness leaves the  
7 room?

8 THE COURT: Sure.

9 MR. BOXER: This Exhibit was initially sent to us --  
10 well, it was said that it would be presented in redacted form.  
11 Then it was disclosed to us in unredacted form and I think what  
12 was just presented was, again, redacted form. We are fine with  
13 and we think it is appropriate for the whole exhibit to come in  
14 without redactions. I wasn't sure if the government was  
15 honoring some internal thought of ours but we would have raised  
16 it before but the last version we saw did not have redactions.

17 MS. KRAMER: So, we realized yesterday that the  
18 version that we had in our system had no redactions and what we  
19 had attached to our motion *in limine* when we just had the draft  
20 form had redactions. Your Honor's ruling was that you were  
21 allowing the report but that some redactions may be appropriate  
22 and so we were trying to honor our initial proposal by  
23 confirming the redactions to the final report of the draft.  
24 Our understanding was that defense counsel wanted those  
25 redactions which is part of the reason they rejected to the

J2C5mid5

Bricker - direct

1 report in the first instance some of the ultimate issue stuff  
2 that's in there. So, I think there was perhaps a  
3 misunderstanding if that's not their current position.

4 THE COURT: Okay. What's the position of defendant?

5 MR. WEDDLE: I totally agree. That's why we wanted to  
6 raise it at the break because I think it is just a  
7 misunderstanding about what people's preferences were. But, we  
8 agree with Mr. Middendorf's counsel that the whole report  
9 should come in, not a redacted version. I don't think  
10 they're -- we can do it on cross but -- I think it was a  
11 misunderstanding about where we stood on that issue.

12 THE COURT: Okay. So, do you have an unredacted  
13 version we can use?

14 MS. KRAMER: I think so, your Honor. Let us confer  
15 and perhaps before we are ready to resume we can let the Court  
16 know where things stand in terms of what we are prepared to do  
17 and if there is any other issue.

18 THE COURT: Okay. Come back in 10 minutes. Thanks.

19 (recess)

20 THE COURT: Have you worked out the issue with the  
21 exhibit?

22 MS. KRAMER: Yes, your Honor. We have an unredacted  
23 version that I will show the witness and offer with defense  
24 counsel's consent.

25 THE COURT: Okay.

J2C5mid5

Bricker - direct

1 All set for the jury?

2 MS. KRAMER: Yes, your Honor.

3 THE COURT: Okay.

4 (Continued on next page)

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Bricker - direct

1 (Jury present; witness resumes the stand)

2 THE COURT: Please, be seated in the courtroom.

3 Good afternoon, folks.

4 THE JURY: Good afternoon.

5 THE COURT: Ms. Kramer, you may proceed.

6 MS. KRAMER: Thank you, your Honor.

7 BY MS. KRAMER:

8 Q. Mr. Bricker, I am showing you what's been marked for  
9 identification as Government Exhibit 5, and Mr. Urbanczyk,  
10 could you scroll through this exhibit, please?

11 Mr. Bricker, do you recognize Government Exhibit 5?

12 A. I do.

13 Q. How do you recognize it?

14 A. I recognize it as a PCAOB inspection report on the 2016  
15 inspections of KPMG.

16 MS. KRAMER: Your Honor, the government offers  
17 Government Exhibit 5.

18 MR. BOXER: No objection.

19 MR. WEDDLE: No objection.

20 THE COURT: Government Exhibit 5 is received.

21 (Government's Exhibit 5 received in evidence)

22 MR. WEDDLE: Your Honor, I'm sorry. Your Honor, can I  
23 revise what I just said which is based on your Honor's ruling?  
24 We stand by our position.

25 THE COURT: Noted.

J2C5mid5

Bricker - direct

1 BY MS. KRAMER:

2 Q. So, before the 2016 inspection report came out, when were  
3 PCAOB inspection reports typically issued?

4 A. The inspection reports are typically issued in the year  
5 following the inspections.

6 Q. In what season or what range of months are they typically  
7 issued?

8 A. So, they would typically be issued in sort of the May to  
9 December time frame. It varies according to firm, but that's  
10 in general terms.

11 Q. So, looking at Government Exhibit 5, when was the 2016  
12 inspection report issued?

13 A. It was issued in January 2019.

14 Q. How does that relate, that release date of January of 2019,  
15 relate to when the PCAOB inspection reports are typically  
16 issued?

17 MR. BOXER: Objection.

18 MR. WEDDLE: Objection.

19 THE COURT: Overruled.

20 You can answer.

21 THE WITNESS: It is issued much later.

22 BY MS. KRAMER:

23 Q. Now, let's look at page 7. Take a look at the paragraph  
24 under the subheading audit engagements selected for inspection.  
25 What does this paragraph say about how many audits were

J2C5mid5

Bricker - direct

1 inspected between late 2015 and early 2016?

2 A. It was 50 issuer audits of a particular type and then one  
3 additional one of a different type. So, in total, it was 51.

4 (Continued on next page)

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Bricker - Direct

1 BY MS. KRAMER:

2 Q. What's your understanding of that advance notice of the  
3 engagements and the PCAOB's ability to write a report of them?

4 MR. BOXER: Objection.

5 MR. WEDDLE: Objection, your Honor.

6 THE COURT: Do you have an understanding of that?

7 THE WITNESS: Yes.

8 MR. WEDDLE: I still have an objection, your Honor.

9 MR. BOXER: Objection.

10 THE COURT: Overruled.

11 BY MS. KRAMER:

12 Q. What's your understanding of that?

13 A. My understanding is that the advance notice of the  
14 engagements was different from the design of the PCAOB's  
15 inspection program generally, and therefore advance notice was  
16 improper because it was being evaluated in relation to the  
17 PCAOB's program and enabled the firm to essentially have more  
18 time and sort of advance time in its audit engagements.

19 Q. What, if anything, do you understand the PCAOB did with  
20 respect to the inspections that were the subject of the advance  
21 notice?

22 A. The PCAOB then needed to go back to those inspections and  
23 review those. The PCAOB also needed to select additional  
24 audits to inspect.

25 MS. KRAMER: Thank you, Mr. Urbanczyk. Let's go to



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1 the next page.

2 Q. Look at the last sentence in the first paragraph on this  
3 page.

4 What's your understanding of how many replacement  
5 inspections the PCAOB conducted after learning about the  
6 advance notice?

7 A. There were ten additional financial institution audits.

8 Q. And what's your understanding about when they took place,  
9 when those inspections took place?

10 A. Those inspections occurred from May 2017 until  
11 October 2017.

12 Q. What's your understanding, if any, about whether those  
13 replacement inspections affected the issuance date of the 2016  
14 PCAOB inspection report?

15 MR. BOXER: Objection. No foundation, your Honor.

16 MR. WEDDLE: Hearsay.

17 MS. KRAMER: I can ask some more questions,  
18 your Honor. That's fine.

19 THE COURT: Okay.

20 BY MS. KRAMER:

21 Q. You testified earlier, Mr. Bricker, that the report  
22 typically comes out between May and December of the year  
23 following the inspections. Is that right?

24 A. That's correct.

25 Q. So for the inspections conducted in 2016, in the ordinary

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1 course, when did you expect to receive that report?

2 A. For the 2016 engagements, ordinarily we would have received  
3 the inspection report in 2017.

4 Q. When in 2017 typically?

5 A. Typically between May to December.

6 Q. And what's your understanding about what the PCAOB was  
7 doing between May and October of 2017 based on the text in this  
8 exhibit that's in evidence?

9 MR. BOXER: Objection, your Honor.

10 MR. WEDDLE: Objection.

11 MR. BOXER: Hearsay. There's no foundation. This is  
12 a witness from the SEC, not the PCAOB.

13 THE COURT: I think he can testify to his  
14 understanding of what it would have been doing.

15 MS. KRAMER: I'll withdraw that question, your Honor.

16 Q. Mr. Bricker, could you read the sentence that has the  
17 yellow highlighting that's on the screen in front of you.

18 A. "The inspections of these ten additional financial  
19 institution audits occurred during the period from May 2017 to  
20 October 2017."

21 Q. Do you have an understanding of whether the PCAOB can write  
22 an inspection report for inspections that it has not yet  
23 conducted?

24 A. No. It cannot.

25 Q. What's your understanding of how long the typical period is

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1 between when the inspections finish and when the report is  
2 issued?

3 MR. BOXER: Asked and answered, your Honor.

4 THE COURT: Overruled.

5 You can answer.

6 THE WITNESS: The typical period would be the  
7 inspections occur during a year, and then the following year,  
8 roughly May to December or so, five to twelve months afterward.

9 Q. When did this report for the 2016 inspections of KPMG get  
10 issued?

11 A. It was issued in January 2019.

12 Q. How, if at all, did the delay in your receipt of the 2016  
13 inspection report affect the functions that you usually use the  
14 inspection reports to perform?

15 MR. BOXER: Objection.

16 MR. WEDDLE: Objection, your Honor.

17 THE COURT: Overruled.

18 THE WITNESS: The delay in receipt delayed our ability  
19 to use the inspection report in all of the ways that we use  
20 inspection reports which include review of the specific issues  
21 identified in the inspection reports for noncompliance with  
22 rules, including with the Commission rules. So that means  
23 referrals to our Division of Enforcement or referrals to our  
24 Division of Corporation Finance as just examples.

25 BY MS. KRAMER:

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1 Q. What, if anything, have you and your staff done to try to  
2 compensate for the delay in receiving the 2016 KPMG inspection  
3 report?

4 A. So to compensate, I and my staff have had direct meetings  
5 with PCAOB -- with the PCAOB, as well as its staff, as well as  
6 meetings with representatives from KPMG.

7 Q. How, if at all, was -- withdrawn.

8 You testified earlier that you play a direct role in  
9 overseeing the PCAOB's budget. Is that right?

10 A. Yes.

11 Q. Are you aware whether or not the PCAOB's allocation of  
12 money was affected by the need to do these replacement  
13 inspections between May and October 2017?

14 MR. BOXER: Objection.

15 MR. WEDDLE: Objection, your Honor.

16 THE COURT: Overruled.

17 THE WITNESS: The allocation of the PCAOB's budget  
18 incorporated allocation for staff to perform the additional  
19 inspections.

20 BY MS. KRAMER:

21 Q. So could you explain what you mean by "allocation of staff  
22 to perform the additional inspections."

23 MR. BOXER: Your Honor, I object to the leading. He  
24 answered the question.

25 MR. WEDDLE: We join, your Honor.

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1 THE COURT: Has your LiveNote stopped?

2 MS. MERMELSTEIN: Ours has stopped.

3 MR. JASON: Yes, your Honor.

4 THE COURT: Could you repeat the question.

5 MS. KRAMER: Sure. I can't remember my question,  
6 your Honor, because I was following up on something specific  
7 the witness said. Let me try the question that I asked  
8 previously.

9 Q. Based on your role at the SEC, do you know how, if at all,  
10 the PCAOB's allocation of money was affected by the need to do  
11 these replacement inspections between May and October of 2017?

12 MR. BOXER: Objection. Asked and answered.

13 MR. WEDDLE: Objection.

14 THE COURT: Overruled.

15 You can answer.

16 THE WITNESS: The budget process incorporates funding  
17 for the inspections group in terms of their needs. And so  
18 their needs incorporated needs in order to do the additional  
19 inspections that are described here.

20 And so part of our review of their budget request and  
21 the support for their budget request included their requests  
22 regarding additional needs and the allocation of PCAOB  
23 resources in order to accomplish this additional work.

24 BY MS. KRAMER:

25 Q. And did you do additional work in connection with the

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1 PCAOB's budget needs as a result of these replacement  
2 inspections?

3 A. Yes.

4 MS. KRAMER: May I have one moment, your Honor?

5 THE COURT: Yes.

6 (Government counsel conferred)

7 MS. KRAMER: Thank you, Mr. Urbanczyk.

8 Q. Are you familiar with the SEC's process for receiving and  
9 reviewing inspection reports?

10 A. Yes.

11 Q. How does the SEC receive PCAOB inspection reports in the  
12 ordinary course?

13 A. In the ordinary course, those reports are received in the  
14 Commission's office of the secretary and then distributed from  
15 that point.

16 Q. We'll get more specific in a moment.

17 But for what general purposes, in your understanding,  
18 does the SEC review PCAOB inspection reports?

19 A. In general, we review inspection reports for, in the  
20 first instance, the information that they include regarding  
21 compliance with SEC rules, PCAOB rules, professional standards,  
22 and so forth.

23 We also use them in the course of evaluating the  
24 performance of auditors generally and our consideration of  
25 PCAOB rules, as well as our own approval of PCAOB's rules and

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1 SEC rules directly. Those are just examples of the way we use  
2 reports.

3 Q. When are inspection reports typically received by the  
4 Office of the Chief Accountant, OCA?

5 A. The inspection reports are generally received at the same  
6 time the public receives them, giving allowance for a couple of  
7 days for the reports to come in to the office of the secretary  
8 and then made available to my staff within the Office of the  
9 Chief Accountant.

10 Q. And within the Office of the Chief Accountant, which groups  
11 get the PCAOB inspection reports when they come in?

12 A. The reports -- just given the confidential information  
13 that's included in those reports, those reports are maintained  
14 by the chief counsel, my chief counsel, in the Office of the  
15 Chief Accountant. So they're maintained there. And then  
16 they're distributed across the office to the individual groups  
17 that I have.

18 I have an accounting group that focuses on accounting,  
19 I have a professional practice group which focuses on audit and  
20 auditor independence, I have an international group, and then I  
21 have the chief counsel and enforcement liaison group. So those  
22 are four groups within my office. And we distribute those  
23 according to our uses for the reports.

24 Q. Do you have an understanding of what the professional  
25 practice group focuses on in reviewing PCAOB inspection

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1 reports?

2 A. The professional practice group focuses on the audit work.  
3 So the professional practice group focused on the inspection  
4 reports for our rule making. My deputy in charge of the  
5 professional practice group manages the rule-making process,  
6 oversees the PCAOB on a day-to-day basis, as well as  
7 administers the auditor independence consultations, the auditor  
8 independence issues that our office addresses.

9 Q. Is the accounting group's process for receiving and  
10 reviewing inspection reports memorialized in a document?

11 A. It is.

12 Q. When you were an accounting fellow at the SEC back in 2009,  
13 did any of your work involve the process by which the Office of  
14 the Chief Accountant receives PCAOB inspection reports and  
15 reviews them?

16 A. It did.

17 Q. What work did you do on that issue when you were an  
18 accounting fellow?

19 A. The work that I did on that issue was to prepare the first  
20 draft of an office policy or process for receipt of the  
21 inspection reports. And how we would review those primarily  
22 focused on accounting issues, about how we would go about  
23 reviewing those reports.

24 Q. And what instructions were you given in connection with  
25 that project back in 2009?



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1 A. The instructions I was given was to start with a draft and  
2 to work with my colleagues within OCA to prepare a document  
3 that would create a much more consistent approach to reviewing  
4 the PCAOB inspection reports.

5 Q. What was your understanding for the reason for that change?

6 A. The reason for that change -- it was precipitated, at least  
7 in part, by the Commission learning or identifying that the  
8 PCAOB had inspected the audit of Lehman Brothers a year prior  
9 to that and wanting a lot more consistency in our review of  
10 inspection reports for those kinds of issues that might be  
11 included in PCAOB inspection reports.

12 Q. What was the outcome of the work that you did on this issue  
13 as an accounting fellow?

14 A. The outcome was the development of an OCA process document  
15 or policy document for doing that work.

16 Q. I'm sorry. For what?

17 A. For reviewing the inspection reports and carrying that out.

18 Q. Okay. I'd like you to take a look at what's marked for  
19 identification ads Government Exhibit 353.

20 Do you recognize this document?

21 A. I do.

22 Q. How do you recognize it?

23 A. I recognize this as a document that I worked on and  
24 supervised when I returned to the SEC. This is a -- because I  
25 returned to the SEC as the deputy chief accountant for the

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1 accounting group, which is just one of the groups within OCA,  
2 one of the early things that I did was to set forth a document  
3 that would describe for the accounting group what was important  
4 in the work of the accounting group and how we would go about  
5 doing that.

6 Q. And is Government Exhibit 353 part of that document?

7 A. It is.

8 MS. KRAMER: Your Honor, the government offers  
9 Government Exhibit 353.

10 MR. WEDDLE: No objection, your Honor.

11 MR. BOXER: No objection, your Honor. We may be  
12 offering additional portions in the future, but no objection to  
13 this document.

14 THE COURT: 353 is received in evidence.

15 (Government's Exhibit 353 received in evidence)

16 BY MS. KRAMER:

17 Q. Now, just looking at the first page for a moment, the  
18 title, Office of the Chief Accountant accounting group, I want  
19 to ask you a question.

20 Is this the strategy document that applies for the  
21 whole Office of the Chief Accountant?

22 A. No. It's just the accounting group.

23 Q. Is there a different strategy document that exists for the  
24 professional practice group?

25 A. There is not a separate sort of documented strategy, but

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1 each of the functional groups was led by a different  
2 individual. So they carried out how to prioritize the work and  
3 how to focus their teams in their own ways. I took the  
4 approach of documenting it in this form and this format.

5 MR. WEDDLE: Objection, your Honor. Move to strike  
6 everything after the word "strategy" at the start of the  
7 answer. Nonresponsive.

8 THE COURT: Overruled.

9 BY MS. KRAMER:

10 Q. When you testified earlier that the accounting group is  
11 focused on accounting issues, what do you mean by that?

12 A. The accounting group is focused on essentially the  
13 accounting standards or the rules of the road that companies  
14 have to follow when preparing their financial statements.

15 We have the professional practice group which focuses  
16 on the auditing of financial statements. There is some  
17 overlap, but in terms of relative emphasis, we're much more  
18 focused on the preparation of the financial statements and the  
19 accounting policies that companies are required to follow.

20 Q. And do you have an understanding of why there is a strategy  
21 document to give guidance to the accounting group on what to  
22 look for in accounting issues when reviewing PCAOB inspection  
23 reports?

24 A. Yes. So the strategy document was important because the  
25 accounting group is the largest group. At the time -- I'll

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1 just give it an approximation -- we probably had 20 people  
2 within that group. And so what I was focused on was providing  
3 consistency to those 20 people so that we were focused on  
4 common issues.

5 But still that group had a role to play in inspection  
6 reports because the inspection reports include PCAOB  
7 inspectors' observations regarding compliance with our rules  
8 which might be accounting issues. So, for example, the  
9 allowance for loan losses is, in the first instance, an  
10 accounting issue. So this group needed to be aware of that.

11 MR. BOXER: Objection, your Honor. It's a narrative  
12 again, and it's not responsive.

13 MR. WEDDLE: We join in that and move to strike,  
14 your Honor.

15 MS. KRAMER: Your Honor, the question was a "why"  
16 question.

17 THE COURT: I agree. Overruled.

18 BY MS. KRAMER:

19 Q. Take a look at page 4. I want to direct your attention to  
20 the bottom paragraph with the subheading Identification of a  
21 Referral Matter.

22 What's a "referral matter"?

23 A. A "referral matter" is a term that we developed as part of  
24 this policy to refer to, identify, a specific item within an  
25 inspection report that we would refer to another group within

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1 the Commission, frequently the Division of Corporation Finance  
2 or the Division of Enforcement.

3 Q. Take a look at the next page, page 5. So look at the  
4 second bullet that says: "The review team should consider  
5 reporting matters that the PCAOB describes as a violation of  
6 SEC rules or regulations."

7 What does that mean?

8 A. That's referring to the review team within OCA should  
9 consider reporting or referring matters that the PCAOB has  
10 described within the inspection report as a violation of SEC  
11 rules or regulations.

12 Q. And is that the review team within the accounting group  
13 within OCA? Or is that in a different group?

14 A. It's principally within the accounting group, but it  
15 included others just to make sure that we had a cross-office  
16 representation.

17 Q. And so take a look in the next sentence: "The team should  
18 avoid reporting matters described as violations by the auditor  
19 of independent standards since those matters are otherwise  
20 assessed by the professional practice group independence."

21 What does that mean?

22 A. So that's referring to the division of responsibilities  
23 within OCA. This is essentially saying don't duplicate the  
24 work that's being done by the professional practice group  
25 because they already have a process for reviewing those issues.

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1 Q. And is there a group within OCA that is reviewing PCAOB  
2 inspection reports for issues of quality control?

3 A. Yes.

4 Q. What group is that?

5 A. The professional practice group.

6 Q. Let's turn to the last page, page 9.

7 If you could just try to expand the entire chart.

8 Generally, what does this chart illustrate?

9 A. So this is a chart that at the time my team and the  
10 accounting group developed to visually depict how inspection  
11 reports were coming into the Commission. So they were received  
12 and then next transmitted -- that's the next row -- to the  
13 Office of the Chief Counsel within my group.

14 Next, to the professional practice group. That's the  
15 abbreviation for PPG. And then it continues with primarily,  
16 you know, the detail being the accounting group because it was  
17 written for individuals within the accounting group.

18 It then continues to the rows below, which CF is the  
19 Division of Corporation Finance. It has its own group of  
20 accountants which they also refer to themselves as a division's  
21 office. IM refers to investment management. That's the  
22 Division of Investment Management. And the last one is the  
23 Division of Enforcement.

24 Q. Do you personally read inspection reports for the largest  
25 accounting firms?

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1 A. I do.

2 Q. Does that include the inspection report for KPMG U.S.?

3 A. Yes.

4 Q. How, if at all, does the SEC's review of PCAOB inspection  
5 reports affect the SEC's ability to fulfill its mission?

6 A. The information in inspection reports is a source of  
7 information for the SEC as we accomplish much more generally  
8 our mission. Our mission starts with investor protection.

9 It includes capital formation. It includes the  
10 fairness and efficiency of our markets. So inspection reports  
11 is a source of how auditors are complying with our rules and  
12 any identification by the PCAOB on deficiencies in compliance  
13 with our rules. All of our rules are, in some way, designed to  
14 promote and further our mission.

15 Q. Take a look at what's marked for identification as  
16 Government Exhibit 354.

17 Do you recognize this document?

18 A. I do.

19 MS. KRAMER: Mr. Urbanczyk, why don't you just scroll  
20 through it quickly, please.

21 Q. How do you recognize this document?

22 A. This is the SEC's strategic plan for the fiscal years of  
23 2014 to 2018.

24 MS. KRAMER: Your Honor, the government offers  
25 Government Exhibit 354.

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1 MR. WEDDLE: No objection.

2 MR. BOXER: No objection.

3 THE COURT: 354 is received.

4 (Government's Exhibit 354 received in evidence)

5 BY MS. KRAMER:

6 Q. Okay. So what is the subheading under strategic plan  
7 fiscal years 2014 through 2018?

8 A. The subheading is: "Protecting investors; maintaining  
9 fair, orderly and efficient markets; and facilitating capital  
10 formation."

11 Q. All right. Let's turn to page 14.

12 What is the strategic objective 1.1 in the red font?

13 A. It is that the SEC establishes and maintains a regulatory  
14 environment that promotes high-quality disclosure; financial  
15 reporting and governance; and prevents abusive practice by  
16 registrants, financial intermediaries, and other market  
17 participants.

18 MS. KRAMER: If you could go back. Thank you.

19 Q. So looking at the text under that strategic objective, take  
20 a look at the third paragraph.

21 What does the first sentence say?

22 A. It says: "The federal securities laws entrust the SEC with  
23 authority to shape the regulatory framework so that investors  
24 are protected through the availability of high-quality  
25 disclosure about their investments."



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1 Q. What do you understand "high-quality disclosure" to mean?

2 A. An example of high-quality disclosure would be financial  
3 disclosures that are complete and accurate and reliable where  
4 investors can have confidence in their ability to rely on that  
5 information when making investment decisions.

6 Q. What's your understanding of what makes a disclosure a  
7 high-quality disclosure?

8 A. It's a high-quality disclosure, as an example, if it  
9 provides honest and accurate and complete information; that is,  
10 it's information that complies with our rules.

11 Q. Let's look at under the heading Initiatives. Do you see  
12 the text: "To accomplish this strategic objective, the SEC  
13 plans to implement the following initiatives"?

14 A. I do.

15 Q. Let's turn to page 16.

16 What is the heading of the initiative next to the  
17 first bullet?

18 A. The heading is "To foster high-quality audits through the  
19 oversight of the accounting profession."

20 Q. What does the first sentence say?

21 A. It says: "The SEC will continue to oversee the Public  
22 Company Accounting Oversight Board and its regulation of  
23 independent auditors through the PCAOB's inspection and  
24 disciplinary programs."

25 Q. What do you understand that to mean?

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1 A. It means the work that we do in overseeing the PCAOB is  
2 important. It also means that its inspection and disciplinary  
3 programs are important elements to that oversight. And  
4 together, all of that work is contributing to the SEC's  
5 strategic plan.

6 Q. And what does the second sentence say?

7 A. It says: "The SEC also will continue to closely work with  
8 the PCAOB on the promulgation and interpretation of auditing  
9 standards to address current issues in the capital markets."

10 MS. KRAMER: Thank you, Mr. Urbanczyk.

11 Q. Are you familiar with someone named David Middendorf?

12 A. I am.

13 Q. How do you know him?

14 A. Through my work at the SEC.

15 Q. Do you remember approximately when you met him?

16 A. Approximately 2015.

17 Q. Do you know what his role was at the time?

18 A. At the time he was the head of KPMG's national office.

19 Q. And what's your understanding of what KPMG's national  
20 office is?

21 A. KPMG's national office, like other national offices, is an  
22 element of a firm's quality control system. So it's a function  
23 within the firm where audit teams can seek advice and  
24 interpretations and support for the judgments that they need to  
25 make.

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1 Q. Did you ever meet David Middendorf face to face?

2 A. I did.

3 Q. One time or more than one time?

4 A. More than one time.

5 Q. Take a look at what's marked for identification as  
6 Government Exhibit 1502.

7 Do you recognize what's in this exhibit?

8 A. Yes. It's a picture of Dave Middendorf.

9 MS. KRAMER: Your Honor, the government offers  
10 Government Exhibit 1502.

11 MR. BOXER: No objection.

12 MR. WEDDLE: No objection.

13 THE COURT: 1502 is received.

14 (Government's Exhibit 1502 received in evidence)

15 BY MS. KRAMER:

16 Q. All right. Let's turn to how you met Mr. Middendorf.

17 Take a look at what's marked for identification as  
18 Government Exhibit 300.

19 Do you recognize this document?

20 Mr. Urbanczyk, if you want to just scroll through.

21 Thanks.

22 A. I do.

23 Q. How do you recognize this document?

24 A. As an email that I was included on, and I authored the  
25 first email in the chain.

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1 Q. You authored the first email in the chain?

2 A. Yes.

3 Q. And is this a series of emails that you sent and received  
4 in the ordinary course of performing your duties at the SEC?

5 A. Yes.

6 Q. Who were you emailing with in this chain?

7 A. I sent an email to the heads of the national offices for  
8 Ernst & Young, PwC, Deloitte, and KPMG.

9 Q. Who was the head of the national office for KPMG if you  
10 know?

11 A. Dave Middendorf.

12 MS. KRAMER: Your Honor, the government offers  
13 Government Exhibit 300.

14 MR. BOXER: No objection.

15 MR. WEDDLE: No objection.

16 THE COURT: 300 received.

17 (Government's Exhibit 300 received in evidence)

18 BY MS. KRAMER:

19 Q. So let's focus on the bottom of the first page at the email  
20 from you dated July 14, 2015.

21 What positions did the recipients in the "to" field  
22 hold at the time you sent this?

23 A. They were responsible -- they were the heads of the  
24 national offices for each of their respective firms.

25 Q. And do you see David Middendorf's name on here?

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1 A. I do.

2 Q. What was the purpose of your email on July 14, 2015, to  
3 these heads of national offices?

4 A. The purpose was to let them know that I would be attending  
5 a CAQ symposium -- CAQ stands for Center for Audit Quality  
6 symposium -- and that I anticipated having time for a  
7 discussion to listen on matters of interest or concern.

8 Q. Let's take a look at the email in the center of the page  
9 that starts out with the word "Wes."

10 Who sent this email?

11 A. Dave Middendorf.

12 Q. What did he say?

13 A. He said that he also would be at the CAQ symposium. It  
14 would be great to introduce himself. He'd also spoken with  
15 Mark Northan who is a KPMG partner, and offered to provide  
16 views on the allowance for loan loss issues.

17 Q. Did you in fact meet him that Sunday?

18 A. I did.

19 Q. Where did you meet him?

20 A. We met at the CAQ symposium after the normal agenda for the  
21 symposium was over.

22 Q. Let's actually look at your response at the top of the  
23 page.

24 What was the date of that Sunday?

25 A. August 9.

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1 Q. Okay. Thank you.

2 So where at the symposium did you meet him?

3 A. As I recall, we met in the symposium room, and we met sort  
4 of at the front of the room after the normal program was over  
5 and most people were exiting the room. So there was an open  
6 table at the front of the room.

7 Q. Do you recall what you discussed that day with David  
8 Middendorf?

9 A. As I recall just generally, I met him, as well as discussed  
10 having a follow-up meeting to talk about the allowance for loan  
11 loss issues.

12 Q. Did he say anything about what the allowance for loan loss  
13 issues were that he was facing?

14 MR. BOXER: Objection. Asked and answered.

15 THE COURT: You can answer.

16 Overruled.

17 THE WITNESS: He described that there were challenges  
18 with the PCAOB inspection process for audits of banks with a  
19 particular focus on the allowance for loan losses.

20 BY MS. KRAMER:

21 Q. Did you have an understanding of what he meant by  
22 challenges in inspections on the allowance for loan loss issue?

23 A. Generally that challenges was referring that PCAOB  
24 inspectors were identifying comments and potential deficiencies  
25 within those audits.

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1 Q. What was the outcome of your conversation with David  
2 Middendorf on August 9, 2015?

3 A. We scheduled a follow-up meeting in Washington at the SEC.

4 Q. Do you know what location of KPMG he worked at at the time?

5 A. As I recall, it was New York.

6 Q. Did you in fact have a follow-up meeting?

7 A. Yes.

8 Q. Take a look at what's marked for identification as  
9 Government Exhibit 301.

10 Do you recognize this document?

11 A. Yes. I recognize it as an email and attached agenda.

12 Q. Did you receive this email that's Government Exhibit 301 in  
13 the course of performing your normal duties at the SEC in 2015?

14 A. I did.

15 Q. And who sent you the email and attachment in the bottom  
16 half of the page?

17 A. Dave Middendorf.

18 MS. KRAMER: Your Honor, the government offers  
19 Government Exhibit 301.

20 MR. BOXER: No objection.

21 MR. WEDDLE: No objection.

22 THE COURT: 301 received.

23 (Government's Exhibit 301 received in evidence)

24 BY MS. KRAMER:

25 Q. So let's focus on the bottom three quarters of the page

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1 beginning with the header information in that email.

2 So what email did you receive from Dave Middendorf on  
3 Friday, August 28?

4 A. I received an email that attached an agenda for a meeting  
5 that was scheduled at my office the following week on Monday.

6 Q. And was the agenda attached to this email?

7 A. It was.

8 Q. Let's look at the next page.

9 Is this the agenda that was attached to the email?

10 A. It was.

11 Q. Focusing on the last non-indented bullet point that begins  
12 with "inspection challenge," "inspection challenge establishing  
13 reasonable assurance," what do you understand this to mean?

14 A. "Inspection challenge" again referred -- I understood that  
15 to mean that the PCAOB inspection process was challenging the  
16 work of KPMG audit teams, and the format in which that was  
17 communicated was through PCAOB comments.

18 The particular challenge -- so the words "establishing  
19 reasonable assurance," "reasonable assurance" refers to the  
20 objective of an audit. The objective of an audit is to develop  
21 reasonable assurance that the financial statements are fairly  
22 presented. So that's a technical reference to the conclusion  
23 that an audit needs to have it supported.

24 Q. When you said a moment ago that the PCAOB was challenging  
25 the firm's work on allowance and expressing deficiencies, how



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1 does that get expressed in part 1 of a PCAOB inspection report?

2 A. So in part 1, part 1 describes those as deficiencies and  
3 then lists the nature of the deficiency. So comments are  
4 descriptions of deficiencies, and the report reflects a  
5 description of those deficiencies.

6 Q. When you met on August 31, 2015, with Dave Middendorf, did  
7 you discuss the items on this agenda?

8 A. We did.

9 Q. Do you recall what, if anything, he said about the  
10 inspection challenges that KPMG was facing?

11 A. What I recall from the conversation was a discussion about  
12 the subjective nature of the allowance and that he thought the  
13 PCAOB was essentially asking for more than what their  
14 methodology could provide. So the three bullets underneath  
15 were examples of some of those issues.

16 Q. What was the outcome of the meeting on August 31, 2015?

17 A. The outcome was more meetings and more discussion as we  
18 sought to better understand what the issues were and what the  
19 root cause of those issues were.

20 Q. Throughout approximately what time period did you continue  
21 to communicate with David Middendorf about this issue?

22 A. Throughout 2015 and into 2016 as I recall.

23 Q. What was your goal in those conversations?

24 A. My goal was to better understand whether there was a  
25 problem with SEC rules as a possible explanation, whether there

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1 was a problem with the KPMG audit methodology as a second type  
2 of explanation, or whether there was some problem with the  
3 inspection process as a possible third explanation. So it was  
4 trying to get a better sense of what the underlying root causes  
5 were.

6 Q. Let's take a look at what's marked for identification as  
7 Government Exhibit 306.

8 Do you recognize Government Exhibit 306?

9 A. I do as a meeting invitation on which I am included.

10 Q. And did you receive this meeting invitation in the ordinary  
11 course of performing your duties at the SEC in 2015?

12 A. I did.

13 MS. KRAMER: Your Honor, the government offers  
14 Government Exhibit 306.

15 MR. BOXER: No objection.

16 MR. WEDDLE: No objection.

17 THE COURT: 306 is admitted.

18 (Government's Exhibit 306 received in evidence)

19 BY MS. KRAMER:

20 Q. Let's focus on the top half of the email that doesn't  
21 include the conference call dial-in information.

22 So what is the subject line of this meeting  
23 invitation?

24 A. ALLL, which stands for allowance for loan and lease losses,  
25 guidance meeting with KPMG.

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1 Q. And where was it to be held?

2 A. At the SEC's headquarters. That's HQ.

3 Q. Where is that?

4 A. In Washington D.C.

5 Q. And when was the meeting scheduled for?

6 A. It was scheduled for October 26, 2015, in the afternoon.

7 Q. Did you attend the meeting that this invitation was setting  
8 up?

9 A. I did.

10 Q. Was David Middendorf there?

11 A. As I recall, yes.

12 Q. What, if anything, was discussed during the meeting about  
13 inspections?

14 A. The premise of the meeting was a carry-on of that prior  
15 discussion that we had, but it was with greater focus on  
16 documents that KPMG had shared with us regarding their methods  
17 and tools.

18 And so we had previously received those and looked at  
19 those. So this was a meeting to discuss observations on those  
20 documents, observations on the auditor guidance that was  
21 included in those documents, and to talk about next steps.

22 Q. And what was your goal in having this meeting?

23 A. To continue our exploration of the issue, again, to better  
24 understand whether there was a problem with our rules or KPMG's  
25 audit methodology and audit approach or whether there was a

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1 problem with the inspections.

2 Q. If you concluded that the problem was with management's  
3 failure to sufficiently calculate the allowance, so the  
4 underlying accounting, what remedies were available to you or  
5 what solutions were available to you?

6 MR. BOXER: Objection, your Honor. The witness  
7 already testified he hasn't concluded anything as of yet.

8 THE COURT: Well, that's right. I don't know if this  
9 is a hypothetical.

10 MS. KRAMER: I'm sorry.

11 Q. Let me ask you again: What were the three potential root  
12 causes that you were exploring in having these communications?

13 A. The three potential were SEC rules. The SEC has rules  
14 for --

15 MR. BOXER: Your Honor, I object. She asked what the  
16 three potential areas were, and the witness repeatedly takes  
17 that as an opportunity to launch into a lecture. He's  
18 previously testified. SEC rules, KPMG inspection challenges.  
19 That was the question that was asked. It's not appropriate for  
20 him to be giving a dissertation.

21 MR. WEDDLE: We join, your Honor.

22 THE COURT: Okay. Try to answer the question  
23 directly.

24 Do you understand the question?

25 THE WITNESS: Perhaps if I could hear the question

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1 again.

2 BY MS. KRAMER:

3 Q. Let me go back for one second.

4 So SEC rules. If you determined that SEC rules were  
5 the cause of the allowance issues that was leading to  
6 inspection challenges for KPMG, what solutions were available  
7 to you?

8 A. We could change our rules. Our rules apply to management's  
9 preparation, the procedural aspects that management has to go  
10 through, just as an example.

11 Q. Do these kinds of communications with accounting firms  
12 contribute to your rule-making work generally?

13 A. They do. They inform us about problems or developments  
14 that need to be incorporated into our rule set. So it's a way  
15 of keeping our rule set current.

16 Q. If you concluded that the inspection challenges on the ALL  
17 issue resulted from the inspection process, what remedies or  
18 solutions were available to you?

19 A. I could propose or I could recommend that the Commission  
20 propose to change the rules. Or I could issue staff guidance,  
21 Commission staff guidance, regarding the preparation of the  
22 allowance. And there is existing staff guidance from OCA that  
23 deals with preparing the allowance for loan losses.

24 Q. Did there come a time that you reached any conclusions or  
25 formed your own view about what the root cause was of this

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1 issue?

2 A. My focus was on ruling things out, and so one thing that I  
3 ruled out was the need to update our staff guidance for the  
4 allowance. I also ruled out the need to recommend that the  
5 Commission change its rules for the allowance. So I ruled that  
6 out.

7 And then that took us to sort of the second  
8 possibility which was the audit methodology that KPMG had. We  
9 were not able to rule that out, but we didn't reach a  
10 definitive conclusion about it.

11 We were able to rule out that the PCAOB inspection  
12 process was somehow different or designed differently for KPMG.

13 Q. Directing your attention to February 9, 2016, did you  
14 participate in any meetings that day with KPMG personnel?

15 A. I'm sorry. Was there something --

16 Q. I want to direct your attention to February 9, 2016.

17 A. Okay.

18 Q. Do you recall participating in any meetings with KPMG  
19 personnel that day?

20 A. Yes.

21 Q. Who was in the meeting that you participated in?

22 A. I participated in a meeting with KPMG's senior partner and  
23 CEO, Lynn Dowdy; KPMG at the time head of their audit, Scott  
24 Marcello; and Dave Middendorf as head of the national office.  
25 Also in the meeting from the SEC was Brian Croteau, the deputy

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1 chief accountant for the professional practice group, and the  
2 then chief accountant, Jim Schnurr.

3 Q. Were you there?

4 A. I was.

5 Q. What was your role at the time?

6 A. My role was the deputy chief accountant for the accounting  
7 group.

8 MS. KRAMER: Your Honor, I see that it's just a few  
9 minutes to 5:00.

10 Is this a logical stopping point?

11 THE COURT: Yes. I think so. It's almost 5:00. I  
12 want to let you all go before 5:00 each day. So why don't we  
13 break today, and we'll continue tomorrow morning.

14 I know you can never predict weather and trains and  
15 all that stuff, but please, please do your best to get here at  
16 9:15. The trial will take longer if anybody is late because we  
17 can't start, obviously, until everyone is here.

18 So please be here at 9:15, and we'll try to start  
19 promptly at 9:30. We'll have more coffee for you tomorrow  
20 morning. I know there probably wasn't enough this morning, but  
21 we're going to get two of those big vats of coffee to make sure  
22 there is enough. It will be there between 9:00 and 9:15.

23 So feel free to come at 9:00 if you want. Try to be  
24 there by 9:15 tomorrow morning. Leave your pads on your  
25 chairs. Don't discuss the case or do any research on the case,

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1 any social media related the case. Have a good night,  
2 everybody, and we'll see you tomorrow morning. Good night.

3 (In open court; jury not present)

4 THE COURT: You may step down.

5 You may be seated.

6 Ms. Kramer, how much longer do you think?

7 MS. KRAMER: We're coming to the end, your Honor.  
8 Probably no longer than 30 more minutes.

9 THE COURT: How many?

10 MS. KRAMER: Thirty at the outside.

11 THE COURT: All right. Anything anybody needs to  
12 address?

13 MR. WEDDLE: Can I just very briefly say one thing,  
14 your Honor. It may not come up again, but I think if there  
15 were more references to things like Lehman, Enron, sort of  
16 scandals of the past injected into the trial, I think there  
17 shouldn't be.

18 I think it's prejudicial and should be excluded. It  
19 may not come up again. There was one mention of Lehman. I  
20 thought we shouldn't be saddling this trial with  
21 responsibilities for a bunch of events that happened in the  
22 past.

23 MR. BOXER: I have a brief matter, your Honor.  
24 Mr. Wada's counsel will take the next witness. So we agreed,  
25 with the Court's permission, that they sit where I'm sitting so



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1 they have a clear view of the witness. I think we'll just sit  
2 in the two chairs behind. Just before doing that, I wanted to  
3 let the Court know.

4 THE COURT: Sure.

5 Who is the next witness? Are you talking about the  
6 next witness?

7 MR. BOXER: Yes.

8 MR. WEDDLE: Mr. Ren.

9 THE COURT: Got it.

10 MS. KRAMER: Very briefly, your Honor, I think the  
11 history of Sarbanes-Oxley, which includes the scandals that  
12 preceded it, is likely to come up again in testimony where  
13 witnesses are talking about the background and the formation  
14 and the purpose of the PCAOB.

15 I don't think that the mention of historical facts  
16 certainly where those scandals are not similar in kind to the  
17 conduct that is at issue in the case is unduly prejudicial.

18 It's fairly difficult to elicit testimony from lay  
19 witnesses about sort of fact and background while trying to  
20 carve out some of just what is history. So I do anticipate  
21 that that will come up again.

22 I don't think we will be doing a deep dive into what  
23 happened in Enron, but I do think there will be mention of it.

24 THE COURT: You think there will be mention of Enron?

25 MS. KRAMER: Yes.

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1 MR. BOXER: I think the issue, the way see it,  
2 your Honor, is are they going to sum up and say, this is  
3 important to prevent another Enron or another Lehman. If  
4 they're just one-offs, I appreciate that it may not resonate  
5 with the jury. If it's going to be part of the summation, I  
6 agree with counsel's observation.

7 THE COURT: I assume it's not going to be a major part  
8 of summation or argument.

9 MS. KRAMER: No, your Honor. We can talk to defense  
10 counsel about this. It's not clear to what extent the defense  
11 is going to be suggesting throughout the trial, on  
12 cross-examination or otherwise, that this was no big deal. So  
13 that may be something that we need to respond to.

14 THE COURT: Okay.

15 MS. KRAMER: I think we can address it as the trial  
16 progresses.

17 THE COURT: I'll think about it as well and be aware  
18 of it. I do think gratuitous references to Lehman and Enron  
19 and things like that, there could be a point where it's  
20 prejudicial. So I think I'll be watching out for that.

21 MR. WEDDLE: Can I just add one thing to this,  
22 your Honor. Enron and Lehman happened a long time before any  
23 of the events at issue in this trial. I think another reason  
24 why it's prejudicial is we could talk about -- we could talk  
25 about all kinds of scandals.

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1           We could talk about he said that they needed more  
2 uniform procedures because of Lehman. I think that that casts  
3 some blame on the SEC for not doing a better job in protecting  
4 investors which he's wrapped himself in that mantel all day  
5 today.

6           We could talk about Madoff, and we could talk about  
7 the SEC's flagging of the Ponzi scheme taking place at Madoff  
8 and doing nothing about it and causing the loss of billions of  
9 dollars.

10          So I don't think we should go there. I don't think  
11 they should go there. It's way afield of anything in this  
12 case, and I think any further discussion of it is cumulative,  
13 given the extensive testimony that's already been elicited from  
14 Mr. Bricker.

15          MS. KRAMER: Your Honor, we could certainly talk about  
16 arguments in closing. I think that is a separate issue from  
17 whether someone is going to be able to, in talking about how or  
18 why the PCAOB was created, will give a brief or not history of  
19 it.

20          I would note that Mr. Middendorf's counsel opened  
21 today, in part, on the fact that the jury will hear from a  
22 witness that the PCAOB is just sort of out to get the firms and  
23 find things that are wrong.

24          There was some mention of kind of the -- whether their  
25 criticism was legitimate and a suggestion that what they're

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1 doing is not based in good purpose. And so I think that we can  
2 certainly discuss it, but where the issue is raised in some  
3 form by defense counsel, we are entitled to respond to that.  
4 So I think that's something to just consider as we're going  
5 forward.

6 (Continued on next page)

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1 THE COURT: Fair enough, but I do think and Ms. Lester  
2 I will give you a chance to respond too, but I do think the  
3 deep background about why the PCAOB was created is a little bit  
4 tangential. It is what it is. We have the regulatory  
5 environment. I obviously gave you a lot of leeway in bringing  
6 out the role of the SEC because I think this witness can  
7 testify about the perspective of the SEC here which is part of  
8 the government's case, but a lot of stuff on why the PCAOB was  
9 created as to what they do now I think could be problematic at  
10 some point. That's my initial view.

11 Did you want to admission?

12 MS. LESTER: I was going to point out that Ms. Kramer  
13 herself said that, factually, the scandals that gave rise to  
14 the creation of the PCAOB are entirely different from what is  
15 present in this trial so I think that points out the prejudice  
16 inherent in the discussion of the creation of the PCAOB and  
17 that our attack in opening was directed more to the inspections  
18 process, as your Honor just pointed out. It is sort of very  
19 different in nature than the general discussion of why the  
20 PCAOB was created.

21 So, I think at the very least, if the evidence is not  
22 precluded entirely, there should be some sort of limiting  
23 instruction about it.

24 THE COURT: Okay. Well, you can let that percolate.

25 MS. KRAMER: We hear you, your Honor.

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1 THE COURT: And if there are issues we need to  
2 anticipate, we can try to do it before a witness who might  
3 implicate them. All right?

4 (Pause)

5 THE COURT: There is one other issue that we just  
6 learned about.

7 Apparently Juror 11, Ms. Dwumah, has an issue with  
8 Thursday. She says she is a teacher who has parent teacher  
9 conferences on Thursday and says she cannot reschedule.

10 Why this just came up -- she just I guess mentioned it  
11 to Mr. Hampton as she was leaving. So, I'm not sure why this  
12 didn't come up before. I guess we will inquire, we will try to  
13 find out more about it tomorrow and see whether that's an  
14 issue.

15 The other thing is if the government could give me,  
16 give us a thumb drive with the exhibits? I believe we got a  
17 thumb drive of the exhibits from defense counsel. We got paper  
18 copies of everything, which I appreciate, but if we can also  
19 get a thumb drive?

20 MS. MERMELSTEIN: Your Honor, I believe we dropped off  
21 a CD but it has gotten lost in the shuffle, we will provide  
22 another one tonight.

23 THE COURT: When did you drop it off?

24 MS. MERMELSTEIN: It is in the binders, it is in a  
25 sleeve.

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1 THE COURT: Oh. You made it obvious. Okay. We were  
2 looking in all the hard places.

3 MS. MERMELSTEIN: But we are obviously happy to get  
4 you another one if it is not there.

5 THE COURT: That's fine. I will confirm that it is  
6 there. Thank you.

7 Have a good night, everybody.

8 (Adjourned to February 13, 2019 at 9:30 a.m.)  
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